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The Organization of Produce Exchanges  
in the United States



THE ORGANIZATION OF PRODUCE EXCHANGES IN THE UNITED STATES

BY

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## INTRODUCTION

### THE ORGANIZATION OF PRODUCE EXCHANGES IN THE UNITED STATES

In the last half century, produce exchanges in this country have developed rapidly as one of the most important economic institutions. They have grown in response to new conditions created by vast industrial and commercial enterprises. At the same time, the tremendous development of transportation and communication facilities has greatly increased their importance. Today, in most civilized nations, produce exchanges are established in order to facilitate not only the local and national, but also the international distribution of commodities.

In order to illustrate the importance of the exchanges, we may take some of the statistical data contained in the reports of the various exchanges. According to the figures given in the annual reports of the Chicago Board of Trade,<sup>1</sup> the total receipts of the six leading articles (flour, wheat, corn, oats, rye, and barley) at the principal western primary markets (Chicago, Minneapolis, Duluth, St. Louis, Milwaukee, Kansas City, Omaha, Peoria, Toledo and Detroit) amounted to over one billion bushels in 1915. This amount of receipts has never been exceeded in any previous year in the history of the exchanges. The receipts of these articles at the above primary markets have been steadily increasing. In 1890 the amount was nearly five hundred million bushels; in 1900, it increased to over seven hundred million bushels;

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<sup>1</sup>Annual Report of the Chicago Board of Trade. 1915: pp. 54-5.





and, two years previous to the present European War, it amounted to a little less than eight hundred million bushels. The rapid increase in production and consumption of these articles in this country is shown by the steady augmentation of receipts at these markets. Further, the tremendous amount of receipts in 1914 and in 1915 must have been due to the large demand of European nations resulting from the present war.

Produce exchanges are indispensable factors for the importation and exportation of agricultural products. For the exportation of grain and provisions, the New York Produce Exchange has been most important. For the cotton exporting trade, the New Orleans Cotton Exchange has been a great factor; while the New York Coffee Exchange is the only existing exchange in this country for coffee. According to the figures given by the New York Produce Exchange, the amounts of wheat and corn exported from New York in 1910 were nearly nine and a half million and eight million bushels respectively; in 1912, wheat exports increased to the large amount of over thirty eight million bushels while corn decreased to five; in 1914, wheat exports were over forty millions and corn nearly four million bushels; and in 1915, wheat exports rose to above ninety million bushels and corn approximately ten million bushels<sup>1</sup>.

Regarding the importance of the produce exchanges, Professor Weld says: "On the whole, the produce exchanges represent the highest type of organization and the highest development of efficiency in marketing that can be found." He further adds: "Cooperation of merchants through exchanges brings about a higher degree of standardization of methods and

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<sup>1</sup>These figures taken from the annual statistical reports of the New York Produce Exchange. 1915.





commodities, elevates the plane of commercial ethics, develops a greater degree of efficiency among members and hence tends to reduce the cost of marketing."<sup>1</sup>

The purpose of this paper is to study the organization of those American produce exchanges which are established in primary markets and in seaboard markets, and in which "future" transactions are carried on. There are, however, numerous so called "exchanges" whose chief function is to furnish a place for the cash transactions and to facilitate trade in the local community. Our main study will be confined to the discussion of the American produce exchanges whose development and significance have been the most striking phenomenon in the history of the world's produce exchanges. A resume of the activities of the Japanese produce exchanges will furnish a supplementary chapter.

The terms "chamber of commerce", "board of trade" and "produce exchange" in this country are used interchangeably owing to their resemblance. Yet, it must be noticed that these names may be used to designate bodies widely differing in the extent of their purposes and activities.<sup>2</sup> For example, the New York Chamber of Commerce was not established as a market place for the exchange of commodities, but was established for the purpose of promoting the general commercial, industrial and financial interests of the City of New York and the State of New York as a whole. On the other hand, although having the same name, the Chamber of Commerce of Minneapolis and the Milwaukee Chamber of Commerce are entirely different from the New York Chamber of Commerce in their purpose

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<sup>1</sup>Prof. Weld: "Marketing Farm Produce", p. 283.

<sup>2</sup>Bisbee and Simonds "Law of Produce Exchanges", p. 23.



and their business activities. They were established for the purpose of giving a market place for those who desire to meet with the view of transacting business. Furthermore, what is known as "Board of Trade" in Minneapolis has been understood to be the same as the New York Chamber of Commerce, or the Philadelphia Board of Trade. Finally even though their names are different the Chamber of Commerce of Minneapolis, the Chicago Board of Trade, the New York Produce Exchange and the St. Louis Merchants' Exchange, are to be considered as similar commercial exchanges in their nature and functions.

In this paper, the term "produce exchange" will be used as a representative name of various commercial exchanges. We may classify these commercial exchanges under two divisions: (1) general produce exchanges; and (2) special produce exchanges. Under the general produce exchanges, the Chicago Board of Trade, the New York Produce Exchange and the St. Louis Merchants' Exchange, etc., are included. These exchanges are established as a market place for general agricultural products, such as wheat, corn, oats, lard, pork, etc. On the other hand, under the special produce exchanges, the New York Cotton and Coffee Exchanges, the New Orleans Cotton Exchange, the New York Metal Exchange and similar kinds of exchanges are included. The New York Coffee Exchange is provided for the coffee trade only<sup>1</sup> and the New Orleans Cotton Exchange in like manner is organized for cotton transactions exclusively.

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<sup>1</sup>The New York Coffee Exchange now includes sugar trade and is named as "The New York Coffee and Sugar Exchange".





Lastly, these produce exchanges are to be carefully distinguished from those corporations organized primarily for the purpose of realizing pecuniary gain from the immediate use of the corporate wealth, for instance, such as banking, insurance, manufacturing, and railroad companies. The produce exchanges are usually prohibited by their charter from transacting any business, excepting such as is strictly necessary to the management of their peculiar affairs. Profits and accumulations of money or property are not authorized to be divided among the members as is the case with share holders in other corporations. In short, the exchanges, as such, are not organized for profit, but are established as a market place for the members who wish to transact business.



## CHAPTER I

### HISTORY OF PRODUCE EXCHANGES

Modern produce exchanges are essentially the product of the 19th century although their origin may be traced back several centuries. Out of the "fairs" of antiquity, there arose the "exchanges". During the 17th and the 18th centuries, these exchanges came into existence in England and other European countries. The names of the Royal Exchange of London, the Antwerp Bourse and some other similar organizations in France and in Germany, which were established during the same period, are generally familiar.

The American produce exchanges, in the modern sense, did not appear until the middle of the 19th century, as was also the case in European countries. Previous to the discussion of the organization and history of these exchanges, it may be worth while to mention some of the most important factors which have been responsible for the growth of these distributing agencies.

One of the chief factors which led the establishment of these exchanges and increased their importance so greatly is the rapid growth of population in this country and the concentration of population in large cities. This increase in the population of our cities has made a large proportion of our people dependent upon these agencies for the distribution of agricultural products. In consequence, produce exchanges as a medium of distribution have become necessary. The following table shows the increase in population in this country as well as in some of the larger cities from 1860 to 1915.





Years	Population of U.S. <sup>1</sup>	New York <sup>1</sup>	Chicago <sup>1</sup>	Philadelphia <sup>1</sup>
1860	31,443,000	813,000	109,000	565,000
1870	38,558,000	942,000	298,000	674,000
1880	50,155,000	1,206,000	503,000	847,000
1890	62,947,000	1,515,000	1,099,000	1,046,000
1900	75,994,000	3,437,000	1,698,000	1,293,000
1910	91,972,000	4,766,000	2,185,000	1,549,000
1915 <sup>2</sup>	100,399,318	5,468,000	2,447,000	1,683,000

Nearly one-tenth of the total population of the United States, exclusive of outlying possessions, in 1910 resided in the three cities - New York, Chicago, and Philadelphia. In 1880, only 2.4 per cent of the population resided in cities of over one million inhabitants, while in 1910, this proportion has increased to 9.2 per cent<sup>3</sup>. Cities of over 100,000 inhabitants together contained a little over 12 per cent of the population in 1880 as compared with .22 per cent in 1910; and 46.3 per cent in 1910 of the population lived in towns and cities of 2,500 or over. The increasing need of distributing agencies or the produce exchanges is thus apparent.

With the increased division of labor and specialization of production has come a tremendous increase in the production of agricultural commodities and a great development in manufacturing and commerce. A brief review of the growth of agricultural production is important

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<sup>1</sup>U.S. Census 1910: vol. on Population, pp. 82-83.

<sup>2</sup>Statistical Abstract 1915, p. 25.

<sup>3</sup>The 13th Census of the U.S. Population. 1910. p. 65.



in understanding the rise of the modern produce exchanges. These agencies have become necessary, not only for domestic distribution, but also for the distribution of our surplus products in the world market.

According to the Census of 1900, the total acreage of farms in this country was estimated at over 400,000,000 acres in 1860; 526,000,000 in 1880; 841,000,000 in 1900; and in the Census of 1910, this amount for the year was 878,000,000. The total production of all cereals was 1,242,000,000 bu. in 1859; in 1869, 1,388,000,000 bu.; in 1889, 3,520,000,000 bu.; in 1899, 4,434,000,000 bu., as against 4,512,000,000 bu. in 1910. Of the most important cereals - corn, wheat, oats - there were produced in 1850, over 592,000,000 bu., 100,000,000 bu. and 146,000,000 bu. respectively; in 1870, these figures increased to 760,000,000 for corn, 287,000,000 for wheat and 282,000,000 of oats. In 1900, corn production increased to the enormous amount of 2,666,000,000 bu.; and wheat production to 458,000,000 bu., while oat production also increased by 943,000,000 bu. The average production of the six years from 1910 to 1915 of each of these articles was approximately 2,800,000,000 bu. of corn, 770,000,000 bu. of wheat and 1,360,000,000 bu. of oats<sup>1</sup>. There has also been an increase in cotton production. In 1849, approximately 2,500,000 bales (400 pounds per bale) were produced; in 1869, 3,011,000 bales (440 pounds per bale); in 1889, 7,500,000 bales (477 pounds per bale); in 1899, 9,534,000 bales (495 pounds per bale); in 1910, over 11,500,000 bales (500 pounds per bale); and for the period 1911-1914, the average production has been estimated at about 15,000,000 bales

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<sup>1</sup>Report of the Chicago Board of Trade. 1915.





(500 pounds per bale)<sup>1</sup>.

In short, in consequence of the introduction of machinery, improved methods and increased farm acreage since the Civil War, the total agricultural production of the United States has increased enormously.

The distribution of such amounts of agricultural commodities has been made possible by the development of our modern transportation and communication systems. In 1859, there were only about 8,500 miles of railroad which served only a small section of the country. In 1914 our railway net had extended to over 279,000 miles, connecting all the producing regions with the consuming and distributing centers. During the same period there was also some development of inland water transportation, but most important has been the growth and improvement of ocean transportation. Ocean transportation has made possible a more effective distribution over a large area and stimulated production in this country for foreign markets. Coincident with this transportation development, have come the improvements in the means of communication such as ocean cables, the telegraph and the telephone.

In the distribution of agricultural commodities all of these factors are of great importance. They have made possible the modern produce exchanges. We may, therefore, conclude that the modern produce exchanges are the necessary outcome of the rapid increase in population and of the development of agriculture, commerce, manufacture, transportation, and communication.

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<sup>1</sup>United States Census of 1900 and 1910 and also United States Census Bureau, Cotton Production.



Thus, the New York Produce Exchange, the Chicago Board of Trade and the St. Louis Merchants' Exchange came into existence before the Civil War although their great business expansion took place after the great struggle. The New York Cotton Exchange, the New York Coffee Exchange, the New Orleans Cotton Exchange, the Minneapolis Chamber of Commerce, the Commercial Exchange of Philadelphia, the Duluth Board of Trade, the Kansas City Board of Trade, and others were founded one after another during the seventies, eighties, and nineties.

The immediate necessity for the exchange which has been previously mentioned, was created by the rapid increase in the volume of trade. This led to the establishment of rules and regulations for systematic trading. The history of produce exchanges in this country may be best illustrated by the study of the evolution of the New York Produce Exchange which is the descendant of previous commercial associations.

As the oldest commercial organization in this country and as the pioneer of the present New York Produce Exchange, there was established in the latter part of the 17th century an organization known as the "Exchange". In 1752 the "Royal Exchange" or the "Merchants' Exchange" was created on the same site of this "Exchange"<sup>1</sup>. These exchanges had been used as a general market place for all sorts of commodities. Their functions and activities were insignificant compared with those of the present exchanges. Organized speculation had not yet been introduced and cash transactions were most important.

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<sup>1</sup>Annals Amer. Acad., vol. 38, pp. 213-14.





During the Revolutionary War the "Royal Exchange" and the "Meal Market" which had been organized for some time, passed out of existence. However, the necessity of such commercial exchanges in the City of New York to meet the increasing demand for American foodstuffs on the part of European nations and a rapid increase in population in New York aroused the business men of that city to the need of reorganizing the exchange and of establishing it in large and convenient permanent quarters. In 1861, the new association was created under the name of the "New York Produce Exchange Company".<sup>1</sup>

This body became known as the "New York Commercial Association" and received its charter in 1862. In 1868 the name was changed to the "New York Produce Exchange". In short, the history of the New York Produce Exchange shows the evolution of the modern exchanges from various commercial bodies which came into existence from time to time to meet the growing commercial requirements.

With its natural advantages of location and its position as the financial center of the country, the City of New York developed rapidly. Coincident with its business growth is the development of the New York Produce Exchange. The following tables of the amounts of receipts and exports at and from New York of the most important articles (wheat, corn, oats) will serve to indicate the importance of the Exchange during the period 1862-1915.

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<sup>1</sup>Annals Amer. Acad., vol. 38, pp. 212-14.



Receipts<sup>1</sup> in bushels:

Years	Wheat	Corn	Oats
1862	27,069,000	17,290,000	5,151,000
1870	23,913,000	9,230,000	9,621,000
1880	59,492,000	61,076,000	13,997,000
1890	15,794,000	34,261,000	33,744,000
1900	31,812,000	47,077,000	32,937,000
1910	16,413,000	12,285,000	23,115,000
1911	28,406,000	16,061,000	24,651,000
1912	45,976,000	7,463,000	24,152,000
1913	52,979,000	10,704,000	20,382,000
1914	50,516,000	14,686,000	27,780,000
1915	99,342,000	14,383,000	38,382,000

Exports<sup>2</sup>:

1862	26,362,000	11,891,000	260,000
1870	18,444,000	469,000	28,000
1880	61,909,000	49,878,000	427,000
1890	12,549,000	24,550,000	9,301,000
1900	21,934,000	43,645,000	14,591,000
1910	9,278,000	7,511,000	1,621,000
1911	20,571,000	12,085,000	1,822,000
1912	38,240,000	5,074,000	5,704,000
1913	49,019,000	5,853,000	4,382,000
1914	40,859,000	3,910,000	10,568,000
1915	91,907,000	9,687,000	17,559,000

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1 and 2 These figures are taken from annual statistical reports and annual reports of the New York Produce Exchange.



Thus the importance of the New York Produce Exchange as a distributing agency has become more and more significant with the growth of the City of New York. Observing these figures of both receipts and exports at and from New York, we conclude that from approximately 80 to 90 per cent of wheat and more than one-half of corn and oats received at New York have been for the purposes of export.

The Chicago Board of Trade was first organized in 1848 as a voluntary association of merchants. At that time Chicago had only 25,000 inhabitants, and had neither railroads nor any other highly developed transportation and communication facilities. In 1859, however, agricultural and commercial expansion finally led to the granting of a charter by the General Assembly of Illinois. Bylaws, rules and regulations were prepared at the first meeting, and a general invitation was extended to merchants to meet daily at the rooms of the Association<sup>1</sup>.

Since its incorporation the rapid increase in population of Chicago as well as of the whole country, the growth of transportation and communication systems and production of agricultural commodities directly stimulated and helped the tremendous business development of the Board of Trade. Furthermore, the natural advantage of location both as to water and rail transportation, and as a consuming and shipping center of the vast agricultural territory in the Middle West, also assisted in the expansion of the Association. Today the Chicago Board of Trade has become one of the largest produce exchanges and the largest grain exchange in

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<sup>1</sup>Annals of the Amer. Acad., vol. 38, pp. 191-2.





this country.

The rapid increase in its volume of trade and its value is shown in the following tables:

Total Clearances of Balances for Years

Years	Total Clearances	Balances
1900	\$62,227,000	\$22,821,200
1902	83,590,000	27,668,000
1904	99,101,000	31,999,000
1906	43,480,000	16,784,000
1908	78,539,000	26,667,000
1910	94,167,000	31,660,000
1912	70,338,000	24,687,000
1913	55,786,278	19,011,000
1914	73,899,000	26,145,000
1915	118,417,845	41,123,008

So far as has been ascertained, the total volume of trade both in the "cash" and the "future" transactions is not available. However, the above amounts of clearings on future transactions, which constitutes a large part of business transactions on 'change, gives some idea of the growth of business of the Chicago Board of Trade.

The following table shows the aggregate receipts and shipments of flour and all kinds of grain in Chicago for the period 1860-1915<sup>1</sup>:

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<sup>1</sup>These figures are taken from the annual reports of the Chicago Board of Trade for several years.





Years	Receipts in bushels <sup>1</sup>	Shipments in bushels <sup>1</sup>
1860	37,235	31,108
1870	60,432	54,745
1880	165,855	154,377
1890	223,320	204,674
1900	349,637	265,552
1910	294,858	214,601
1911	291,267	221,429
1912	322,008	244,423
1913	383,494	274,286
1914	416,872	316,293
1915	371,135	299,090

Thus the rapid increase in receipts and in shipments at and from Chicago of these articles and the steady augmentation of business transactions are strong evidences of importance and indispensability of the Chicago Board of Trade as a factor in distribution of agricultural commodities.

Other exchanges such as the Chamber of Commerce of Minneapolis, Duluth Board of Trade, the St. Louis Merchants' Exchange, the New York Cotton Exchange, the New Orleans Cotton Exchange, the New York Coffee Exchange, have had a similar development.

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<sup>1</sup>In thousands of bushels.



## CHAPTER II

### THE PRESENT ORGANIZATION OF PRODUCE

#### EXCHANGES

##### A. Charter or Articles of Incorporation

Produce exchanges are generally chartered in this country either under the general laws of state or by a special legislative enactment. Formerly charters were granted by special acts, but today the greater number of produce exchanges and corporations are organized under state laws of general application. Organized under the general laws of state are the Chamber of Commerce of Minneapolis, the Duluth Board of Trade, the Omaha Grain Exchange, the New Orleans Cotton Exchange, and others. The Chicago Board of Trade, the New York Produce Exchange, the New York Cotton Exchange, the New York Coffee Exchange, and the Milwaukee Chamber of Commerce are organized under special legislative acts.

##### B. Powers which are given by a Charter or Articles of Incorporation.

Produce exchanges as other corporations are given by their charter some corporate name, power to adopt a common seal with the right to alter the same at pleasure, to sue and to be sued, to plead and to be impleaded, to take and hold by gift, grant, purchase, and devise, both real and personal property to an amount specified in the respective charter, and to dispose of the same by sale, lease, or otherwise, and power to adopt such rules, regulations and by-laws as may be deemed necessary for self government<sup>1</sup>.

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<sup>1</sup>See charter in Report of Chicago Board of Trade, or charter of any other produce exchange.



It should be noted that such rules, regulations and by-laws are conditioned by the laws and constitutions of the state and of the United States<sup>1</sup>. Thus the amount which is specified in the charter of the Chicago Board of Trade for the real and personal property at present (1915) must not exceed \$200,000, while that of the New York Produce Exchange is limited by the amount of \$1,500,000<sup>2</sup>.

There are several items which usually are prescribed in the charter. These are the number of officers and method of electing them, of admitting and dismissing members, of constituting or appointing the committees of arbitration and appeals, and of requiring a bond for officers.

Sometimes, as is the case of the New York Produce Exchange and the Milwaukee Chamber of Commerce and some other exchanges, but not the Chicago Board of Trade, the charter confers the power to convert the surplus money and property of the association into a gratuity fund for the benefit of members, or for their widows and heirs; and furthermore, these exchanges are authorized to assess a fixed amount to each member, the same to be paid as a death benefit. For this matter, the New York Produce Exchange and others provide several articles in their charters and by-laws<sup>3</sup>.

The charter also creates the power to execute awards and findings declared by the committees of arbitration and appeals. This is the case

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<sup>1</sup>Bisbee and Simonds: Law of Produce Exchange.

<sup>2</sup>Annal report of the New York Produce Exchange. 1915. Charter.

<sup>3</sup>See: Reports of the N.Y.P.E. Charter.





of the Chicago Board of Trade, the New York Produce Exchange, and some other exchanges. Smaller exchanges organized under the general laws of the states such as the Minneapolis Chamber of Commerce, the Duluth Board of Trade, the Omaha Grain Exchange, have no such peculiar powers as the power to execute awards declared by these committees.

Lastly, the power is given by the charter to inflict fines upon any one of the members who violates its rules, regulations or by-laws. "No such fine shall exceed five dollars", says the charter of the Chicago Board of Trade. Further it states "Such fine may be collected by action of debt, before a justice of the peace in the name of the corporation"<sup>1</sup>. The Milwaukee Chamber of Commerce may recover any fine imposed by the Chamber by the action of any court.

### C. Membership

Membership may be defined as the right or privilege to act as a member of the exchange under the charter and by-laws.

1. Limitation or non-limitation.- In this country either limitation or non-limitation of membership is adopted by the exchanges. The Chicago Board of Trade, the Duluth Board of Trade, the Toledo Produce Exchange and some other exchanges have no definite limit regarding their membership. On the other hand the New York Produce Exchange, the New York Cotton Exchange, the New Orleans Cotton Exchange, the Chamber of Commerce of Minneapolis, the Milwaukee Chamber of Commerce, the New York Coffee Exchange, the St. Louis Merchants' Exchange, etc., have a provision for

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<sup>1</sup>Report of the Chicago Board of Trade, 1915, Appendix p.6.



limitation of membership in their respective by-laws.

The following figures show the present numbers of members in various produce exchanges<sup>1</sup>.

Names of Exchanges	Present Number	Number of Limitation
The Chicago Board of Trade	1620	No limitation
The Duluth Board of Trade	204	" "
The Kansas City Board of Trade	200	" "
The Toledo Produce Exchange	48	" "
The New York Produce Exchange	1780	2,200 limitation
The New York Cotton Exchange	425	450 "
The New York Coffee Exchange	323	350 "
The New Orleans Cotton Exchange		500 "
The St. Louis Merchants' Exchange	1090	1090 "
The Milwaukee Chamber of Commerce	565	565 "
The Omaha Grain Exchange	200	200 "

The question of limitation or non-limitation of membership has been much discussed. Theoretically speaking, however, the limitation of membership may give the exchange more dignity than would otherwise be possible; and also it affords the exchange an opportunity to select the most desirable persons for its members. Consequently, the exchange can enforce its rules and regulations with perhaps greater ease and effectiveness. On the other hand, the limitation of membership naturally tends

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<sup>1</sup>These figures were obtained from Secretaries of respective Exchanges in October, 1916.





to confine the special and peculiar advantages to the limited number of persons.

Mr. J. G. McHugh states his view on this question as this:

"The limitation gives the membership privilege a certain value and by virtue of the fact that the membership privilege is valuable, makes it comparatively easy for the board of directors to secure obedience to the rules of the corporation on account of the fear of suspension or expulsion in case of violation of the rules. In those grain exchanges where membership is unlimited or exceedingly large, memberships have comparatively little value, and as a consequence it is much more difficult to secure strict compliance with the rules and regulations on the part of members."<sup>1</sup>

The following brief statements are the opinion of some of the secretaries of various produce exchanges from whom information regarding this question has been obtained. The question asked was, "Do you think limitation or non-limitation of membership is more desirable? Why?"

In favor of non-limitation Mr. J. C. F. Merrill of the Chicago Board of Trade says: "To remove all possible suggestions of monopoly"; Mr. C. F. McDonald of the Duluth Board of Trade states: "Free from close corporation or monopoly charge"; the Secretary of the Toledo Produce Exchange says: "No limit best. More traders make better market."

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<sup>1</sup>J. G. McHugh: "The Formation, Development and Economic Functions of Grain Exchanges", 1914, p. 2.



In favor of limitation Mr. Thomas Hale, Jr., of the New York Cotton Exchange states: "Limitation is more desirable than non-limitation in an organization of this character. Our trading 'ring' in busy markets is of itself sufficient evidence that limitation is justified"; Mr. Eugene Smith of the St. Louis Merchants' Exchange says: "Number of membership is limited under our rules. It is considered more desirable than an unlimited membership, as otherwise any one desiring membership could come in for a year or two, drop same, and then if his business justified it, come back again the same as in a commercial club or commercial organization, which would thereby restrict the value of a membership, or the value of holding membership in an exchange in which to do business"; Mr. F. P. Manchester of the Omaha Grain Exchange says: "I am of the opinion that a limited membership is more desirable than an unlimited, but, in most cases, this is in conflict with the law"; Mr. Henry G. Hester of the New Orleans Cotton Exchange states: "This is a question on which there is much difference of opinion. The founders of this exchange favored limitation of membership, hence made it a part of the organic law of the institution."

Seven out of the eleven most important produce exchanges with whom the writer recently communicated, are in favor of limitation, while only four of the eleven are in favor of non-limitation.

In the opinion of the writer, neither side overweighs the other, but it depends chiefly upon the conditions and circumstances of each particular exchange. The limitation of membership does not necessarily indicate a small membership and the non-limitation of membership is not always coupled with a large membership. As a matter of fact, the New York Produce Exchange limits its membership to 2,200 although the present





number of members is 1,700. While there is no limit regarding the membership in the Chicago Board of Trade, it has only 1,620 members.

In the past, the New York Produce Exchange, the Minneapolis Chamber of Commerce and some other exchanges removed this limit in order to satisfy complaints. It is obvious that the limitations do not greatly affect the number of members, in several instances. Consequently, the question of limitation or non-limitation of membership leads to the question of admission to membership.

If there be strict rules providing for the admission to membership, there will be a smaller number of members, even though there be no limitation. On the other hand with a limitation and rather easy rules or proceedings concerning the admission of members, there will naturally be a larger number than would otherwise be the case.

In order not only to select members from the wealthy commercial interests, but also to keep the exchange membership at a higher standard, it is necessary to charge a certain high initiation fee and to provide strict rules for the admission of members.

2. Qualification for Membership.- The Chicago Board of Trade states in its general rules the qualification for membership as "any person (male) of good character and credit, and of legal age". The New York Produce Exchange uses the term "any respectable person". The Minneapolis Chamber of Commerce says "any person of legal age". The Commercial Exchange of Philadelphia states "any respectable individual, firm, or corporation". The Milwaukee Chamber of Commerce uses the words "any male person of legal age". The New Orleans Cotton Exchange says: "All persons legally of age and of good character and commercial standing, whether





resident or non-resident of New Orleans, may be elected members of this Association."

The first step in obtaining a membership is to make a presentation of a written application to the secretary, stating the business, location, the name of the firm and other necessary facts concerning the applicant. The Chicago Board of Trade requires the applicant to have two members of the Association indorse the application, while the New York Produce Exchange states that "any respectable person, on the proposal of one member seconded by another"<sup>1</sup>. On the other hand, the St. Louis Merchants' Exchange does not require any member's indorsement or proposal, but does provide further details of applicant's business and personal affairs instead, such as the business, location, the name of the firm, co-partnership, or association with which he is connected, and the name of the individual members, and also three references to the applicant's business character and standing<sup>2</sup>.

The next step toward acquiring a membership will be the posting of the application on the bulletin board of the exchange for the purpose of securing the unanimous agreement of the members, and then the approval of the board of directors. Previous to the approval of the board of directors, the membership committee takes charge of the investigation regarding the applicant's personal character and business credit. The Chicago Board of Trade in this connection provided as follows: "Such

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<sup>1</sup>Report of the N.Y.P.E. 1915. p. 60. Appendix.

<sup>2</sup>Bisbee and Simonds: Law of Produce Exchange. p. 33.



application shall have been posted on the bulletin board of the exchange and after 10 days it may be admitted to membership upon approval by at least ten affirmative ballot votes of the board of directors; provided that three negative ballot votes are not cast against such applicant"<sup>1</sup>. The New York Produce Exchange provides practically the same rule with the exception of the approval of the committee on admission and election by the board of managers. A quite different method from either the Chicago Board of Trade or the New York Produce Exchange is practiced by the New Orleans Cotton Exchange. Instead of electing the applicant by the board of directors, the general election for the applicant takes place at the general exchange rooms on Wednesdays. Its rule provides that "each elector shall cast one ballot - if in favor of the candidate, the word "yes", if against, the word "no" written or printed thereon. Three-fourths of the whole number of votes cast shall be required in favor of applicants to entitle them to membership"<sup>2</sup>.

Other exchanges such as the Minneapolis Chamber of Commerce, the Milwaukee Chamber of Commerce, the Commercial Exchange of Philadelphia, and others adopt either of the three types of method above discussed. Of course the length of time for the posting of the application and the number of ballot votes of the board of directors differ in each exchange.

3. Certificates of Membership and Assessments.- Finally those who are admitted are entitled to receive a certificate of membership

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<sup>1</sup>Report of the C. B. of T. 1915. Appendix. p. 29.

<sup>2</sup>Report of the New Orleans Cotton Exchange. 1915. p. 26.





bearing the corporate seal, and the signature of the president and secretary<sup>1</sup>. The certificate of membership can be transferred when any member wants to resign or desires to transfer his membership to another person who is eligible to membership. This requires the approval of the board of directors in the Chicago Board of Trade. In the New York Produce Exchange, it is necessary to have an election by the board of managers of the person to whom the membership will be transferred. In both cases the payment of a transfer fee is charged<sup>2</sup>. Another case in which the certificate of membership can be transferred is when a member dies. In this instance it can be done through a legal representative. In all exchanges, unpaid assessment, dues or any payment due to the member who desires to transfer is an obstacle to the transfer of membership.

All applications for membership come through the secretary to the committee of membership which holds regular meetings to find out the applicant's personality, financial standing and other necessary evidences, as requested by the board of directors.

The annual membership dues (assessment) are made by the board of directors and must be paid in within a certain length of time after it has been fixed. The annual assessment in every exchange has been one of the largest items of income. An initiation fee is paid by each member but this is not paid until a person becomes a member. In some exchanges

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<sup>1</sup>The Commercial Exchange of Philadelphia provides that those who are admitted are entitled to receive one or more certificates of membership.

<sup>2</sup>Transfer fee: Kansas City B. of T., \$500.00; Chicago B. of T., \$100.00; New York Cotton Exch., \$25.00; Duluth B. of T., \$10.00; New York P. E., \$50.00; Minneapolis C. of C., \$15.00; Philadelphia C. Exch., \$5.00.



the initiation fee is not charged for each member. Such is the case in the Omaha Grain Exchange and in the St. Louis Merchants' Exchange.

The following figures show the amount of the annual assessment, initiation fee, and market value of membership in various exchanges.

Name of Exchange	Annual Assess't.	Initiation fee	Market Value
The Chicago Board of Trade	\$75	\$1,000	\$7,500
The New York Produce Exchange <sup>1</sup>	25		1,800
The New York Cotton Exchange <sup>2</sup>	125	1,000	17,250
The New York Coffee Exchange	50	1,000	5,000
The Duluth Board of Trade	60		5,000
The Minneapolis Chamber of Commerce	35		500
The Commercial Exchange of Philadelphia		250	150
The St. Louis Merchants' Exchange	40		250 to 300
The Kansas City Board of Trade		10,000	7,500
The Toledo Produce Exchange	100	50	50
The New Orleans Cotton Exchange	125	500	6,350
The Omaha Grain Exchange	50		3,500

4. Suspension and Expulsion of Members.- Suspension is the penalty declared by the exchange upon a member by withholding all the privileges of membership during a prescribed period. Expulsion forces such member to withdraw his membership from the exchange.

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<sup>1</sup>Annual dues for regular members are \$25 besides gratuity assessment of about \$200. For associate members \$100 is charged as annual dues and no gratuity assessment.

<sup>2</sup>The value of the latest sale.





Suspension or expulsion are declared by the exchange upon a member according to the nature of his offense, and to the rules and regulations and by-laws which provide the penalties. The Chicago Board of Trade provides in its rules several sentences for suspension and expulsion of membership. The chief items for suspension are enumerated as follows:

- (a) For failing to comply with the terms of any business obligation.
- (b) For failing to comply with the award of any committee of arbitration or appeals.
- (c) For acting as both principal and agent in any transaction in any commodity dealt in under the rules of the board.
- (d) For acting in any transaction in the position of agent for both seller and buyer (This section shall not apply in case of exchange of cash property.)
- (e) For neglecting or refusing to appear, testify and produce books or papers when in any investigation or trial before the board of directors or before any other duly constituted committee or other tribunal of the association.
- (f) For a member, who knows the insolvency of his principal or corporation with which he is connected, making any contract resulting in pecuniary loss to the party.
- (g) For being guilty of improper conduct of a personal character in any of the rooms of the association or violating any of the rules, regulations or by-laws of the association.





Expulsion will be declared by the exchange upon any member for serious misconducts. The following are the chief items which, in most of the exchanges, are grounds for expulsion:

(a) Dealing in differences:

Being interested or associated with or acting as the representative of any order for the account of any organization, firm or individual engaged in the business of dealing in differences on the fluctuations in the market price of any commodity.

(b) "Bucketshop":

Acting as agent or on behalf of himself transacts business of any bucketshop in the exchange or any other exchanges.

(c) Distribution of quotation:

Permitting the distribution of quotations of the association, whether acting as an agent or principal of any trade executed upon the exchange from any member of a market or an exchange in the city.

(d) Compulsory "open market trades":

Any order received by any members of this association from any firm, corporation or individual to buy or sell for future delivery (except in case of cash property) must be executed in the open market in the exchange hall during the hours of regular trading.

(e) Insolvency:

This is the same in case of suspension, and depends upon the decision of the board of directors whether the guilty member will be suspended or expelled.



- (f) The making or reporting of any false or fictitious purchase or sale, or any dishonest conduct.
- (g) Trading in "pits" or "calls" by members, or member forms in outside exchanges or the making of contracts to be fulfilled by the delivery of local warehouse receipts.<sup>1</sup>

There are few differences in rules and regulations regarding suspension and expulsion of members among the exchanges. It can be assumed that the above enumerated cases practically cover most of the cases. In short, any member of an exchange shall be punished, either suspended or expelled, upon any offense or misconduct which is indictable at common law, or any conduct contrary to the member's duty or obligation, in other words, against the rules and regulations of the exchange.

5. Reinstatement and Readmission to Membership.- Every exchange provides in its by-laws and rules for reinstatement and readmission of suspended and expelled members. A suspended member in the Chicago Board of Trade may be reinstated by a majority vote of a quorum of the board of directors. The rule states: "An expelled member, however, shall not be readmitted to membership except upon payment of the regular initiation fee and annual assessment, and upon satisfactory evidence that he is a fit person for membership in this association, and then only upon

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<sup>1</sup>In some exchanges the "pit" and "call" are not strictly prohibited by the rules, such is the case in the Milwaukee Chamber of Commerce.





an affirmative vote of at least twelve members of the board of directors; provided, that three negative votes are not cast against such applicants for readmission"<sup>1</sup>. Either a suspended or an expelled member who is declared guilty upon false testimony, or in case satisfactory evidence is presented of error in the decision of the board of directors, may be reinstated or readmitted to membership.

The New York Produce Exchange provides the same rules for reinstatement of a suspended member, but for an expelled member the exchange requires the affirmative vote of three-fourths of all the members of the board of managers present. The Milwaukee Chamber of Commerce requires the unanimous approval of the committee of membership for readmission of an expelled member.

6. Associate Members.- The term "associate member" used in the New York Produce Exchange, the New York Cotton Exchange and some other exchanges, denotes a person who is granted all the privileges of the exchange with the exception of the voting power. They are not eligible to the membership of either the board of managers or of any committees of the exchange except the trade committee<sup>2</sup>.

Associate members are required to pay \$100 as an annual assessment and \$25 for transfer fee. They are also subject to all the rules

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<sup>1</sup>Chicago Board of Trade, Report of 1915. p. 16. Appendix

<sup>2</sup>Report of the New York Produce Exchange, 1914-15. p. 100.



regulations and by-laws of the exchange.

D. Government.

In this section our chief attention will be directed toward the executive officers and the board of directors owing to the fact that the government of the exchange is vested in these persons. The closely related functions and powers of the committees of arbitration and appeals will demand a special discussion in connection with the study of the government. Relatively little space will be given to the discussion of other committees, by-laws, rules and regulations.

1. Officers of the exchanges, terms of office, duties, etc.-

By the officers of the exchanges are here meant the executive officers of the management of the exchanges which include a president, one or more vice-presidents, a secretary, a treasurer and other minor officers such as inspectors, weighers, and gaugers.

The Chicago Board of Trade has one president, two vice-presidents, one secretary with an assistant secretary, and one treasurer with an assistant treasurer, while the New York Produce Exchange has only one vice-president and no assistant secretary or treasurer. In the Milwaukee Chamber of Commerce the office of the secretary and treasurer is conducted by one person.

The officers chosen by ballot are generally president and vice-president, but in some cases secretary and treasurer are also elected annually. The New York Produce Exchange provides in its charter and by-laws for the annual election of such officers as the president, vice-president and treasurer who hold their office for the term of one year. In the Chicago Board of Trade the president and one vice-president





are elected annually; and the president holds his office for one year while each vice-president holds office for two years. The Milwaukee Chamber of Commerce provides for annual election of officers and both the secretary and treasurer are elected annually. In every exchange a certain number of the board of directors are annually chosen by ballot; and each member of the board usually holds office for two or three years.

The president is the chief executive officer of the exchange as in case of any other corporation. The president and in his absence, the vice-president, acts as general executive officer of the exchange. He presides over all the meetings of the exchange and of the board of directors. It is the president's duty to preserve order and a proper business decorum in the exchange and other rooms of the association. He has power to call special meetings of the board of directors and of the association when necessary. Upon the written request of a certain number of members, he shall call a special meeting of the exchange. Regarding the written request for a special meeting of the exchange, the Chicago Board of Trade requires twenty-five members of the association, the Minneapolis Chamber of Commerce and the Duluth Board of Trade requires ten members, the New York Produce Exchange provides a majority of the board of managers or seventy-five members, and the Omaha Grain Exchange requires three members of the board of directors or twenty-five members of the exchange.

In some exchanges the power to appoint standing committees is vested in the president, although generally this power is conferred upon the board of directors. For example, the Commercial Exchange of Philadelphia provides in its by-laws that the president shall appoint





the following standing committees: the committee on finance, on rooms and fixtures, and on membership, etc. In the Omaha Grain Exchange the president has the power to appoint special committees if necessary for the management of the exchange.

The president generally has the power also to fill a vacancy in any appointive offices of the association. He shall be a member ex officio of all committees except the arbitration committee. This is the case in the New York Produce Exchange and the Commercial Exchange of Philadelphia.

The secretary and an assistant secretary are usually appointed by the board of directors but in some cases they are elected. In the Milwaukee Chamber of Commerce, the secretary is elected annually and is a member of the board of directors.

Chief duties of the secretary are to preserve all the records of the exchange, to keep a journal of the proceedings of the association, to collect statistical information, to publish the annual report, to attend all meetings of committees, to collect and pay over to the treasurer all money due to the exchange, to sign official certificates of appointment of officers and employees, and to give notices of meetings of the exchange. The secretary also takes charge of the seal, books, papers and personal property belonging to the exchange.

The secretary of the produce exchanges on the whole performs just the same functions as a secretary of any other corporation.

The treasurer of the produce exchanges like the secretary, is generally appointed by the board of directors, but in some exchanges such as the New York Produce Exchange, the Milwaukee Chamber of Commerce, the



New Orleans Cotton Exchange, the treasurer is elected by the members of the exchange annually. Furthermore in these exchanges the treasurer is also a member of the board of directors or managers.

The duties of the treasurer, which vary but little in different exchanges, are to receive all securities and money due to the association, to pay all money on the order of the secretary, to keep accounts of receipts and disbursements of funds, and to make a full report to the association of all accounts. He is also required to make a report at each regular monthly meeting of the board of managers in the New York Produce Exchange. The Minneapolis Chamber of Commerce provides that the treasurer shall make monthly or quarterly reports to the board of directors of the accounts of the association.

2. Board of Directors or Managers.- The government of the produce exchange is vested in the board of directors; and the central power of the exchange is conferred upon the same body. All business and financial affairs of the association are conducted and managed by, or under the direction, of this board in accordance with the charter, rules, regulations, and by-laws.

The constitution of the board of directors is somewhat different in each exchange. However, generally it is composed of the president, vice-presidents, and several directors. In a few cases, both the secretary and treasurer are included in the members of the board, and also in a few exchanges the treasurer and not the secretary is a member of this board.

The board of directors of the Chicago Board of Trade consists of the president, the vice-presidents, and fifteen directors including the president and the vice-presidents. The New York Produce Exchange





provides that the board of managers shall consist of the president, vice-president, treasurer and twelve managers. The Milwaukee Chamber of Commerce includes the secretary and treasurer in the board of directors with nine other directors besides the president and vice-presidents. The Minneapolis Chamber of Commerce has thirteen directors including the president and two vice-presidents.

The president and vice-presidents as previously stated are elected annually and hold office for one year; but, in case of two vice-presidents, one vice-president is elected annually and each vice-president holds office for the term of two years. This is the case in the Chicago Board of Trade and some other exchanges. If the secretary or treasurer is a member of the board, he holds his office for one year. Other directors usually hold office for the term of two or three years. Thus, the directors of the Chicago Board of Trade and the Milwaukee Chamber of Commerce hold their office for three years. Four and three of the directors are annually elected in the respective exchanges. In the New York Produce Exchange, the Commercial Exchange of Philadelphia, and the Minneapolis Chamber of Commerce, the term of the director's office is fixed at two years. In the New York Produce Exchange and the Commercial Exchange of Philadelphia, six of the directors are elected annually, and in the Minneapolis Chamber of Commerce, the number so elected is five.

The most important duties and the supreme powers of the exchange are conferred upon the directors. The board's actions are vitally connected with the prosperity of the association. Their duties and powers, however, can not be exercised beyond the scope of the charter, by-laws, rules, and regulations.

The chief duties and powers of the board provided in the charter,



by-laws and rules are: To manage business and financial concerns, to appoint committees, officers and employees, to accept bonds for officers and employees, to provide suitable rooms, to act as a quorum for the transaction of business to censure, suspend, and expel guilty members, to reinstate and readmit such guilty members, to audit all claims, to inquire into matters affecting the welfare of the association and of the community, to determine the annual assessment, to conduct the public auction for a sale of the certificate of membership, to request attendance of persons and a presentation of papers when an investigation is necessary, and to adopt and establish rules and regulations.

Besides these enumerated duties and powers, the Chicago Board of Trade and some other exchanges provide that one of the duties of the board shall be to fix and establish a standard grade and other grades for flour, grain and other commodities. They also fix the minimum amount of transaction for future delivery. In the Chicago Board of Trade, the Minneapolis Chamber of Commerce, the New York Produce Exchange, the New York Cotton Exchange and some other exchanges, the board of directors has the power to establish proper rules and regulations governing the exchange clearing house. The board of directors of the Milwaukee Chamber of Commerce is authorized to establish a freight bureau for securing just and equitable rates. The board of directors of the Chicago Board of Trade is empowered to organize a "Car Inspection Department" and to fix the fee for such service; and also to establish a "Custodian Department" to take care of all commodities.

There are still several minor duties and powers of the board of directors such as the powers of appointing delegates to the National Board of Trade, of employment of legal advisers, of control over co-part-





nership, of filling any vacancies in the board of directors.

In short, the duties and powers of the board of directors, although the most important, are not inconsistent with the charter, by-laws, and rules. Efficiency in management, speediness in transactions and effectiveness in service on the part of the association and of the members, are all closely dependent upon the exercise of duties and powers of the board of directors.

### 3. Committees (or boards) of Arbitration and Appeals.-

a. Committee of arbitration. The underlying principle of the creation of the committee of arbitration is to adjust by arbitration those differences which occur between individuals. This idea is an old feature of the common law<sup>1</sup>. Under the present complex business methods and organization, most of the produce exchanges in this country are given power of punishment of their members by their charter or by-laws in order to settle the disputes which occur among the members. The purpose of giving such special power to the exchanges by the state apparently is due to the fact that the exchanges themselves are in a more favorable position to decide all disputes arising from complicated transactions of the exchanges, and further that in order to realize the greatest self-government, it is far better to permit them to arbitrate and decide any controversy among themselves.

Another purpose of this peculiar power given to the exchanges

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<sup>1</sup>Bisbee and Simond, "Law of Produce Exchange". p. 36.





is to facilitate commercial transactions with the least possible inconvenience, and to keep a high standard of commercial dignity, and to increase the interests of each member as well as of the public.

For these purposes the exchanges have generally the committees of arbitration and appeals. Those exchanges organized under a special legislative act such as the New York Produce Exchange, the Chicago Board of Trade and the New York Cotton Exchange are given by their charter power to create the committee of arbitration and, further, a special power is given to the committee of arbitration with regard to the settlement of disputes. The decisions of this committee are binding and final unless further actions are taken. Moreover, an exceptional power is given to these exchanges by state laws whereby the decisions of this committee are given the force of court orders. On the other hand, those exchanges, organized under general corporation laws, have no such special powers concerning the settlement of disputes.

The following statement is found in the charter of the Chicago Board of Trade: "Said corporation may constitute and appoint committees of reference and arbitration, and appeals, who shall be governed by such rules and regulations as may be prescribed in the Rules, Regulations and By-laws"<sup>1</sup>. The New York Produce Exchange provides that, "The Board of Managers shall annually elect, by ballot, five members of the Exchange who shall not be members of the Board, as a committee to be known and styled the Arbitration Committee of the New York Produce Exchange"<sup>2</sup>.

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<sup>1</sup>Chicago Board of Trade, Report 1915. p. 6. Appendix.

<sup>2</sup>New York Produce Exchange, Report 1914-15. p. 64.



The committee of arbitration is either elected by the members of the exchange or by the board of directors. It is generally composed of either five or ten members of the exchange who are not members of the board of directors or managers. Each member of this committee usually holds office for the term of two or three years. The Chicago Board of Trade provides in its rules that; "There shall be elected by the members of the Association a Committee of Arbitration and a Committee of Appeals, consisting of ten members each, who shall hold their respective office for the period of two years"<sup>1</sup>. Furthermore, no member can be on both committees. The arbitration committee of the New York Produce Exchange is elected by the board of managers, and it consists of five members of the exchange who are not the members of the board of managers. The Minneapolis Chamber of Commerce has practically the same provision for this committee. It provides that: "There shall be elected by the members of the Association a Board of Arbitration and Appeals to consist of five members each, who shall hold the respective offices for the term of two years, or until their successors shall have been elected and qualified"<sup>2</sup>. The New Orleans Cotton Exchange provides: "an Arbitration Committee, to consist of nine members, to be appointed annually by the Board of Directors at their first meeting"<sup>3</sup>.

Duties and powers of the committee of arbitration are naturally confined by the charter, by-laws, rules and regulations of the exchange.

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<sup>1</sup>Chicago Board of Trade, Report 1915. p. 10. Appendix.

<sup>2</sup>Report of the Minneapolis Chamber of Commerce, 1904. p. 2

<sup>3</sup>The New Orleans Cotton Exchange, "Charter, Constitution, By-laws and Rules". p. 24.





They are more or less similar in each exchange. The effect or validity of the decisions of the committee of arbitration of the Chicago Board of Trade, the New York Produce Exchange and some other exchanges differs largely from that of other exchanges such as the Duluth Board of Trade, the Chamber of Commerce of Minneapolis, the Omaha Grain Exchange, and others. In the former case the decisions of the committees of arbitration and appeals are final and binding and not subject to revision by any other tribunal of the exchange; in other words they have the same effect upon the members as the courts' decisions. In the latter case the decisions of these committees are binding upon the members, but they have not the same effectiveness as the ruling of the courts.

The main duty of the committee of arbitration is to determine all claims submitted by the members, and is to render justice and equity in decisions. The Chicago Board of Trade has a rule which states: "It shall be the duty of the Committee of Arbitration to hear and determine all cases of disputed claims voluntarily submitted for this adjudication by members of the Association"<sup>1</sup>.

By its nature and function, the members of the committee of arbitration and also the committee of appeals are required to take an oath or affirmation before the entering upon the duties of their offices. The oath is similar in each exchange. Here may be quoted an example of such oath from the Chicago Board of Trade. It reads: "You do solemnly swear (or affirm) that you respectively will faithfully and fairly hear

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<sup>1</sup>Report of the Chicago Board of Trade, 1915. Appendix. p. 27. Both the Chicago Board of Trade and the New York Produce Exchange state in their charter that any persons who are not members of the association can submit any controversies upon any members.



and examine all matters of controversy which may come before you during your tenure of office, and that you will in all cases make just and equitable awards or finding upon the same, in conformity with the Rules, Regulations, and By-laws of the Association, and according to the evidence, to the best of your understanding; so help you God"<sup>1</sup>.

Chairman or acting chairman of the committee of arbitration may require suitable oaths from the parties and witnesses of the submission of the controversy. A fine may be assessed for failure to attend the hearings without a satisfactory excuse on the part of the members of this committee. The Chicago Board of Trade, the Omaha Grain Exchange, and the Duluth Board of Trade provide that such fine shall be three dollars for each default.

b. Committee of appeals. The nature and purpose of the committee of appeals are considered practically identical to those of the committee of arbitration. It is created either under the charter or by-laws of the exchange, or under the general laws of the state. This committee is sometimes called the complaint committee as in the New York Produce Exchange. There is a difference between the Chicago Board of Trade and the New York Produce Exchange in this respect. In the former, the committee of appeals like that of arbitration, appears in its charter, while in the latter the committee is provided in its by-laws, although the committee of arbitration is prescribed in its charter. Further, the members of this committee of the Chicago Board of Trade are elected

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<sup>1</sup>Report of the Chicago Board of Trade, 1915. Appendix. p. 28.





by the members of the exchange. On the other hand, the members of the complaint committee of the New York Produce Exchange are elected by the board of managers and also the committee itself is appointed by the president, upon the approval of the board of managers.

The constitution and terms of office of the committee of appeals are the same as those of the committee of arbitration in each exchange.

The duties of the committee of appeals are to review the decisions of the committee of arbitration when such decisions are brought before it, to modify or amend such decisions, and to render such final judgment as may seem just. This committee also may receive and hear such new testimony as may be offered under oath. Such is the case in the Chicago Board of Trade, the Milwaukee Chamber of Commerce and others. On the other hand, in case of the St. Louis Merchants' Exchange this committee can not take any new testimony, but must confine itself within the limit of the testimony taken by the committee of arbitration.<sup>1</sup>

The complaint committee of the New York Produce Exchange is quite different from the committee of appeals in other exchanges. It does not review or amend or modify such decisions applied by the committee of arbitration. Its powers resemble the powers of the board of directors of other exchanges to some extent. For example, the committee can summon before it any member who is accused by another member of wilful violation of the charter or by-laws or rules<sup>or</sup>/of any other misconduct.

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<sup>1</sup>Bisbee and Simonds, "Law of the Produce Exchange". pp. 31-2.





When the complaint committee can not solve or arbitrate the disputes, then the complaint may be referred to the board of managers who may take final action on the complaint.

Any member or non-member of the exchange who desires to submit any controversy against another member to either the committees of arbitration or appeals, is required to file a written complaint with the secretary, or in case of the complaint committee of the New York Produce Exchange, with the chairman of that committee, stating his cause of action and demand. A copy of such complaint may be sent to the opposite party by the secretary. In the New York Produce Exchange where any complaint or controversy arises against agents of any corporation or firm, the principal may be substituted for such agents and be responsible for their offenses. When any complaint/<sup>is</sup>made against non-members who transact business through a member of the exchange, the same procedure is followed. The final action may be taken by the board of managers.

The Chicago Board of Trade provides that when any members of the committees of arbitration and appeals are unable to be present at the hearing, the parties of the controversy are allowed to fill the vacancy with any members of the association who are not members of other committees. Furthermore, there is also-called "special committee of arbitration" in the Chicago Board of Trade. This committee is composed of three or more members of the exchange who are not members of any other committees, and who are chosen by the parties in controversy when such parties are not willing to submit their controversy to the committee of arbitration. It is necessary, however, for the parties to agree upon the committee by writing to the secretary<sup>1</sup>.

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<sup>1</sup>Report of the Chicago Board of Trade, 1915. p. 28. Appendix.



Fees for cash arbitration and appeals are charged by the exchange according to the amount of controversy. Such fees collected by the exchange will be distributed equally among the members of the committees.

For each controversy, the following figures show the amount of fees charged by the Chicago Board of Trade<sup>1</sup>.

Amount of Controversy	Amount of Fees
Under \$500	\$10
From \$500 to \$1,000	15
" 1000 " 1,500	20
" 1,500 " 2,500	25
" 2,500 upward	50

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Fees are doubled when arbitration and appeals/made by non-members.

The New York Produce Exchange charges \$10 for each complaint made by a member and the fees are divided equally among the members of the complaint committee. The Commercial Exchange of Philadelphia provides fees for arbitration and appeals as follows: "Fees of \$15 will be charged in each case for an arbitration and the same amount of fee will be charged for an appeal except in case the amount of controversy is over one thousand dollars, then \$25 will be charged for each controversy"<sup>2</sup>.

Rules and regulations provided for the committees of arbitration and appeals in other exchanges not mentioned here, are more or less

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<sup>1</sup>Report of the Chicago Board of Trade, 1915. p. 29. Appendix.

<sup>2</sup>In: Report of the Commercial Exchange of Philadelphia. 1915. p. 90.





similar to those which we have quoted.

For the sake of clearness, the aforesaid discussion may be summarized in a few lines. The committees of arbitration and appeals are generally created either under the charter or under the general laws of the states. These committees are organized for the prime purpose of arbitrating any disputes arising from the transactions among the members of the exchange and between the members of the exchange and non-members. Professor Emery of Columbia University states that: "The rôle played by the Arbitration Committee has been an important one, and the power and dignity conferred upon it by the charter is significant of the high position and great influence in the commercial world of such a corporation as the New York Produce Exchange"<sup>1</sup>.

Duties and powers of these committees, therefore, are of vital importance. Their awards and findings are final and binding.

4. Other committees.- In order to realize self-government and efficiency in trade, the members of the exchange are divided into several committees. Committees are classified under a few big divisions such as standing committees, general committees, trade committees and special committees. Such classification is primarily a matter of practice and depends chiefly upon the circumstances in each exchange. For example, the Chicago Board of Trade has several standing committees of the board of directors, although some of the members of the association are members of the standing committees. There are special committees

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<sup>1</sup> Emery, "Speculation on the Stock and Produce Exchanges". pp. 27-8.



separately organized from standing committees. Both the committees of arbitration and appeals are established independently from any other committees. On the other hand, the New York Produce Exchange has three divisions, as standing committees, general committees and trade committees. The committees of arbitration and complaint are included in the standing committees. The Milwaukee Chamber of Commerce provides committees of the board of directors, general committees and a committee on commerce and manufactures.

For the sake of convenience, the discussion of various committees will be taken up under three divisions as standing committees, including general committees, trade committees and special committees.

Standing committees are one of the important parts of the organization of produce exchanges. They are usually such as committees on finance, rooms and fixtures, law, flour, house, information and statistics, membership, arbitration and appeals. The Chicago Board of Trade includes several committees in this division such as warehouse, grain, inspection and "to arrive" grain, etc. Committees of the board of directors of the Milwaukee Chamber of Commerce are really the same as the standing committees here considered.

Generally speaking, these committees are appointed either by the president upon the approval of the board of directors or by the board of directors. For instance, in the New York Produce Exchange these committees are appointed by the president upon the approval of the board of managers except in case of the arbitration committee which is elected by the board of managers. In the Chicago Board of Trade, on the other hand, the board of directors appoint these committees





upon the nomination of the president.

The constitution of these committees differs more or less in each exchange. One exchange provides the members and qualification of the members of each committee and the others simply provide the qualification of the members of each committee. The New York Produce Exchange in its by-laws distinctly states the number and the qualification of the members. For example, the finance committee has to consist of three members of the board of managers, and the complaint committee consists of five members of the exchange, not members of the board of managers. Still, the committee of trade and transportation is composed of five members of the exchange of which at least one must be a member of the board of managers. The Chicago Board of Trade provides that "the transportation, grain and inspection committees, for the purpose of having the proper branches of trade represented may be selected in part or wholly from the other members of the Association"<sup>1</sup>.

The duties of these committees are different, according to their different purposes. Take some of the committees for an illustration. The duties of the finance committee of the New York Produce Exchange are to audit all bills or claims against the exchange, and also to audit the monthly accounts of the treasurer and to direct all payments, deposits, and investments. The trade and transportation committee has various duties pertaining to matters of trade, transportation, storage, and terminal charges, etc. This committee necessarily

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<sup>1</sup>Report of the Chicago Board of Trade, 1915. p. 19. Appendix.





takes care of all matters coming under their supervision, and considers and recommends such action as, in its opinion, would promote trade interests. It has several other duties such as receiving all protests or complaints against trade or transportation and obtaining just and equitable principles for these matters and employing with the approval of the board of managers several clerks, etc. The committee on admissions has the same duties as the membership committee in other exchanges. Its constitution, however, is quite different from any other membership committees. It is constituted by the members of the floor committee and of the board of trustees of the gratuity fund.

The committee on commerce and manufactures of the Minneapolis Chamber of Commerce must be considered like in character to the trade and transportation committee of the New York Produce Exchange. The duties of this committee, according to the rules of that chamber, are to report to the board of directors or to the chamber, "information upon every specific subject relating to the modes and means of transportation, or to measures for building up and extending the commerce and manufactures of the City of Minneapolis, and to recommend such action from time to time as it shall deem wise in relation thereto".

General committees in the New York Produce Exchange are those on canals, exports, relief, bills of lading, etc., while in the Milwaukee Chamber of Commerce under this division there are committees on supervisors of grain and flour, on inspection of various articles, on weather reports, membership, etc.

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<sup>1</sup>Report of the Minneapolis Chamber of Commerce, 1904. pp. XVI to XVII.



There are various kinds of trade committees, such as, in the New York Produce Exchange, committees on grain, provisions, flour, lard, seed, pig-iron, butter and cheese, and the like<sup>1</sup>.

Each committee consists of several members and of those who are familiar with each particular trade. The Chicago Board of Trade does not provide as many committee as the New York Produce Exchange has, but it has a few committees for trade such as on grain, weighing and custodian, market report, provisions, inspection, flour inspection, etc.

Special committees, as the name implies, are established for particular purposes as the needs of each exchange require. The Chicago Board of Trade has two committees of this class. They are committees on promotion and on Chicago Association of Commerce. They are appointed by either the president or the board of directors or by the association. The committee on Chicago Association of Commerce has no duty or function which directly affects the interest of the exchange, but it has a particular duty which promotes the relation between the exchange and the association.

All committees, standing, general special and trade, are subject to the rules, regulations and by-laws of each exchange, and are supervised by the board of directors. They are responsible for their own particular actions and are required to report to the board of directors or to the association.

5. By-laws, Rules and Regulations.- With the increase in volume of trade and the complexity in business methods came the necessity of establishing by-laws, rules and regulations. They are absolutely

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<sup>1</sup>See: Report of N.Y.P.E.





necessary to the management of the internal government of the exchange to the uplift of commercial dignity and to the trade operations. Particularly, the conditions of speculative transactions require very strict and detailed rules and regulations.

The establishment of by-laws, rules and regulations are authorized under the charter. Nevertheless, what matter should be provided in by-laws and what matters in rules and regulations seem to be in question. No general answer can be given to this matter. The question, however, depends chiefly upon the conditions of each particular exchange. For example, the Chicago Board of Trade provides in its by-laws for a few matters which are not essential to the management or business transactions of the exchange. On the other hand, the New York Produce Exchange, the Omaha Grain Exchange and others provide in their by-laws all the necessary provisions for the management of the exchange such as government, election and duties and powers of officers, annual meeting, various committees and their constitution and duties, membership and annual assessment, rooms, hours of trading, etc. The rules of the Chicago Board of Trade make practically the same provisions which are seen in the by-laws of various other exchanges. Furthermore, the Minneapolis Chamber of Commerce provides all matters in general rules without by-laws and regulations.

Regulations are generally divided into several branches according to the kind of trade. For instance, the regulations of the Chicago Board of Trade are: Those of the inspection of flour and provisions, of grading and inspection of flaxseed, of timothy, clover and other grass and field seeds, of inspection of hay and straw, of the clearing house, of weighing



of grain, etc. Besides these regulations, the board provides several of the requirements of warehouses for the storage of provisions and requirements for grain warehouses in order that their receipts shall be regular for delivery on grain contracts. The New York Produce Exchange has similar regulations such as rules regulating flour, provisions, lard, grain, inspection and grading of grain, etc. Like rules and regulations are found in the Commercial Exchange of Philadelphia and other exchanges.

Concerning the question of regulations, Professor Emery states that "the future once established, transactions for future delivery increased enormously on those exchanges which formed the chief markets of the country. The necessity of uniform and fixed regulations for such contracts, and the increased complexity of a growing business, led to the gradual growth of a body of rules on the various exchanges by which all the details of such contracts are regulated"<sup>1</sup>.

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<sup>1</sup>Emery: "Speculation on the Stock and Produce Exchanges". p. 40.



### CHAPTER III

#### BUSINESS METHODS OF PRODUCE EXCHANGES

The preceding chapter has dealt with the present organization of produce exchanges. Now, our discussion may be directed toward the study of business methods which are practiced on various exchanges. Owing to the importance of warehouse and inspection systems, this subject will be considered previous to the discussion of business methods.

##### A. Warehouse System

In order to facilitate trade operations the warehouses issue their receipts which are generally transferable, and which in some states are negotiable. Without such an instrument as warehouse receipts, the present "future" transactions and the great volume of trade could not be performed.

Warehouses are located in the primary markets, in the seaboard markets and along railroad lines for the purpose of storing the commodities which may be demanded from time to time. Under the present highly developed system of trading, the commodities subject to the transactions, must be kept in a good condition without any deterioration in quality and unreasonable shrinkage in quantity. For this purpose, every exchange has special regulations regarding storage in regular warehouses. Each warehouse receipt, therefore, must be issued by the regular warehouses recognized by the exchange.

The Chicago Board of Trade makes several requirements concerning the regular warehouses such as location which must be conveniently approachable by vessels, the storage rates which shall not be in excess





of one cent per bushel for the first ten days and one thirtieth of one cent per bushel for each additional day, the financial and personal standing of the proprietors or managers, and sufficient bonds. The New York Produce Exchange provides that: "The Board of Managers may designate warehouses in the port of New York whose receipts shall be regular, upon the written application of the owners, lessees or chief officers thereof, (who must be members of the exchange) endorsed by not less than five members of the Grain Trade"<sup>1</sup>. In the meaning of the rules of the New York Produce Exchange, regular warehouses include only those in which grain is stored in bulk, and in which the grain of different owners is mixed. In other words, grain is stored such a way that the identity of different lots is not accurately maintained. Furthermore, it provides that two or more warehouses owned or operated by one individual, firm or corporation, in which graded grain is stored, are designated as a "system". These warehouses belonging to the "system" can issue their receipts without designating the particular warehouses in which the grain is stored.

By the rules of the New Orleans Cotton Exchange, a warehouseman or pressman who owns a warehouse or cotton press must be recommended by the committee on supervision and deliveries and approved by the board of directors, if a license is to be obtained from the exchange. Negotiable press or warehouse receipts, provided in the rules of the New Orleans Cotton Exchange, for the fulfillment of a contract for future delivery must be signed by the warehouseman or pressman, indorsed by the party

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<sup>1</sup>The New York Produce Exchange, Report 1914-15. p. 157.



in whose favor they are drawn and they must also be accompanied by a certificate of grade issued by the inspection bureau<sup>1</sup>. The rule provides that this certificate of grade shall be binding on all parties unless superceded by a certificate of grade by the Secretary of Agriculture. Moreover, the weight, as noted by the inspection bureau on the press or warehouse receipts, shall be binding on all parties, and an allowance of a half pound per bale per month, or fraction of a month, is provided excepting when delivery is made within 15 days, in which case no allowance is made.

Analogous provisions regulating to warehouses are found in other exchanges. There are, however, other requirements which provide that all regular warehouses are subject to the rules and regulations of the exchange, that every regular warehouse is obliged to make a report daily and weekly to the exchange showing the quantity and kind of grain which is in storage, and also the quantity and kind of grain received and shipped daily, etc.

Summing up the question of warehouses, it is evident that the functions of warehouses are recognized as one of the important factors which enable the organized produce exchanges to function as great distributing agencies for agricultural products. Stringent rules and regulations concerning warehouses, therefore, are provided in every exchange.

Further, by means of warehouse receipts, which are either transferable or negotiable, great convenience and service in business operations are obtained. It must be remembered that the standardization

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<sup>1</sup>See: The New Orleans Cotton Exchange, Charter, Constitution, Rules and By-laws. pp. 89-90.





of weighing and of classification in quality and quantity, and the establishment of an efficient inspection system are the chief factors which give warehouse receipts their peculiar business value.

B. Inspection and Grading Systems.

The system of grading grain and other commodities has been developed within very recent years. It is the result of the tremendous expansion of trade operations; and it is said to be American in its origin. The importance of the grading system has been recognized because of the enormous increase in volume of trade and the specialization of business. This specialization is noticeable in the diversified production of agricultural commodities under scientific management. The significance and convenience of the system of grading not only to farmers and traders but also to the public as a whole are immeasurable. It is particularly important when the business transactions are largely performed by the "future" or "short sales" methods.

At the present time most of the middle western states have adopted a system of state grain inspection. In each of the states, Illinois, Minnesota, Missouri, Kansas, Indiana, and some other states, there is a State Grain Inspection Department. While other commodities such as provisions, flax seed, grass seeds, lard, etc., are inspected and graded under the rules and regulations of the exchanges. Necessary officers and employees such as inspectors, weighers, and others, are appointed by the exchange for this purpose. On the other hand, in the New York Produce Exchange, the Commercial Exchange of Philadelphia, and some other exchanges, the system of grading and inspection both of grain and other commodities are conducted under the direction of the exchange



authorities. Under the rules of the New Orleans Cotton Exchange, the grading of cotton is directed by the board of classers which consists of from three to seven recognized experts (including the inspector-in-chief) who are appointed by the board of directors. The determination of grades by the board of classers, however, must be guided exclusively by the "Official Cotton Standard of the United States".

State inspection of grain was established in Illinois in 1871 and in Minnesota in 1885. The chief inspector who is appointed by the governor with advice and consent of the senate in Illinois, and who is appointed by the Railroad and Warehouse Commission in Minnesota, has the general supervision of the general inspection department in each state<sup>1</sup>. Necessary employees, such as assistant inspectors, are nominated by the chief inspector and appointed by the Board of Railroad and Warehouse Commissioners, both in Illinois and in Minnesota.<sup>2</sup>

Several methods of inspection of grain have been practiced in these states. Formerly all inspections were made at the side of the cars as they came to the Chicago or Minneapolis yards. This method is known as "track inspection". Recently, the present method known as "room inspection" has been adopted. Comparative merits of these two methods apparently are in favor of the room inspection. The track inspection has the disadvantage of the separate judgment of each inspector, while the room inspection has the advantage of the possible combined judgment of several inspectors. Further, the room inspection makes possible

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<sup>1</sup>J. C. F. Merrill: Annals of the American Academy of Political and Social Science, 1911. Vol. 38. pp. 58-60.

<sup>2</sup>Ibid.





laboratory work that is necessary.

Under the present system of inspection of grain, samples are taken from different parts of all the cars by the expert samplers and are taken to the office of the state inspection department where the actual examination takes place. The actual grading and inspection of grain done under the State Grain Inspection Department of Illinois is directed by the supervising inspector under whom several inspectors and assistants are working. The collections of samples are directed by the chief sampler who supervises and controls several groups of samplers.

Whenever any shipper or any trader is dissatisfied with the grades fixed by the inspection department, he may request a reinspection. The committee of appeals is provided for any further dissatisfaction on the part of the owner of grain concerning the grades determined by the inspectors.

The differences in grading systems in various states and exchanges have caused many difficulties and much confusion in interstate commerce in grain. In order to avoid such difficulties, and in order to secure uniformity in grading and inspection of grain for interstate or foreign trade, the United States Grain Standard Act was passed in August, 1916, and became effective in December, 1916.

### C. Business Methods.

1. "Cash" and "futures".- In every produce exchange under our consideration, two different kinds of transactions are carried on. One is called the "cash" or "spot" transaction, and the other, the "future" or "pit". The cash transaction is a sale of commodity between the buyer and seller upon the agreement of delivery of goods and of payment in





a short interval. Also, this transaction is made on the basis of samples which are furnished on the tables in the exchange. On the other hand, the future transaction is a contract between the buyer and seller who agree to buy and to sell a certain commodity at some prescribed future time at a stipulated price. The essential distinction between the two is the element of time. Professor Emery says in this connection that "the cash or spot contracts are merely the outright sale and purchase of goods for immediate delivery"<sup>1</sup>, and "a future is a contract for the future delivery of some commodity, without reference to specific lots, made under the rules of some commercial body, in a set form, by which the conditions as to the unit of amount, the quality, and the time of delivery, are stereotyped, and only the determination of the total amount and the price is left open to the contracting parties"<sup>2</sup>.

The characteristics of the "futures" are: (1) that the seller has the right to hold the goods or is not obliged to deliver the same until the last day of the prescribed month; and (2) that there are specified lots fixed by the exchange to be contracted for by the parties. In other words, the seller can deliver the goods to the purchasers at any time between the first and the last day of the month designated and the amount of contract must be in accordance with the specified lots determined by the exchange. For example, in the Chicago Board of Trade, grain transactions are in 5,000 bushels lots, flax seed in 1,000 bushel

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<sup>1</sup>Emery: Speculation on the Stock and Produce Exchanges. p. 47.

<sup>2</sup>Emery: Speculation on the Stock and Produce Exchanges. p. 46.



lots, lard in 250 package lots, and pork in 50 package lots<sup>1</sup>. In the New York Produce Exchange, the contract amounts for grain are 5,000 or 1,000 bushel lots. Sales of grain in boat-load lots, however, shall be in 8,000 bushel lots, corn and rye in 8,500 bushel lots; and barley and oats in 10,000 bushel lots<sup>2</sup>. In cotton transactions this amount is fixed by both the New York and New Orleans Exchanges at 5,000 bales (500 pounds per bale).

Another feature of the "future" is the practice of "contract grades" which are fixed by the exchanges. In this respect, there is a difference between the grain exchanges and cotton exchanges. In grain exchanges such as the Chicago Board of Trade, the New York Produce Exchange and others, the seller is allowed to deliver any one of the contract grades and the buyer must receive whatever grades the seller delivers within the contract grades. On the Chicago Board of Trade this term comprises, as regards wheat, a tender of No. 2 Red Winter, No. 1 Northern Spring, No. 2 Hard Winter, No. 1 Hard Winter, and No. 1 Velvet Chaff<sup>3</sup>. In other exchanges different requirements for contract grades exist. In the Minneapolis Chamber of Commerce, No. 1 Northern Wheat, No. 3 corn, No. 3 white oats, and No. 1 flax seed are the contract grades<sup>4</sup>. The contract grades on the New York Produce Exchange are in regard to wheat No. 2 Red Winter, No. 2 Hard Winter, No. 1 Hard Winter, and No. 1. Northern Spring, but No. 3 Red Winter, No. 3 Hard

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<sup>1</sup>See: Report of the Chicago Board of Trade, 1915. Appendix. p. 54.

<sup>2</sup>See: The New York Produce Exchange Report, 1914-15. p. 169.

<sup>3</sup>Report of the Chicago Board of Trade, 1915. Appendix. p. 52.

<sup>4</sup>Report of Minneapolis Chamber of Commerce, 1904. p. xxxi.





Winter and No. 3 Northern Spring may be delivered at a discount of five cents<sup>1</sup>.

On the other hand, in "futures" of cotton transactions, "basis" contracts are used, that is, the parties to the contract do not call for the delivery of a specific grade of cotton, but allow the seller the option of delivering any grade or a number of grades within certain wide limits. The buyer has no option in this respect. "Middling" cotton is always the "basis" grade and can be delivered on contract at exactly the contract price. Nevertheless, any other grades within the limits can be delivered at prices relative to "middling", that is to say, at certain differences in price "on" or "off" "middling". Thus, if an operator sells a "future" contract at 10 cents, he can if he prefers deliver a higher grade or a lower grade of cotton, like "good middling" or "low middling". However, in the former case the buyer must pay, in addition to the basis price of 10 cents, a premium of, say, one-half cent "on" that price, and in the latter case, the buyer must take it, but is allowed a deduction or discount "off" the contract price. In the same way the seller may deliver both high and low grades on a single contract<sup>2</sup>.

As a matter of fact, in the past there were no uniform or standard grades of cotton in this country and considerable variations existed between markets. What was called "middling" in Augusta, Georgia, was very different from and much higher than that of Savannah and Charleston<sup>3</sup>. However, the cotton standards have been fixed by the Secretary of Agriculture since passage of the United States Cotton Futures Act in 1914,

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<sup>1</sup>Report of the New York Produce Exchange, 1914. p. 169.

<sup>2</sup>U. S. Commission of Corporation Report on Cotton Exchange. Part 1-3. p.2.

<sup>3</sup>Annals of Amer. Acad. Vol. 38. p. 265.



and a uniformity of cotton standards has been realized throughout the country.

Previous to the United States Cotton Futures Act there were two different methods adopted in determining the premiums and discounts for the "future" transactions. The New York Cotton Exchange used the method of "fixed differences" and the New Orleans Cotton Exchange, that of "commercial differences". Under the method of "commercial difference" the premiums and discounts allowed for better and poor grades were fixed by the "spot" quotation, that is to say, by the actual selling prices of the different grades at the time of delivery. However, the New York method was rather arbitrary, for, the premiums and discounts were determined by a committee known as the revision committee, at stated periods. Under the present act the method of determining such differences is distinctly provided for and both the New York and New Orleans Cotton Exchanges are now practicing the same method, which is based on a "commercial differences"<sup>1</sup>.

2. "Short" sale.- The "short" sale is impossible without the method of the "future" transaction. It is a contract for a sale in which a certain commodity is to be delivered at a prescribed future time, and is not in the hands of the seller at the time when the contract is made. Of course the seller expects to hold the commodity before the time of delivery comes. To quote Professor Emery again: "The development of the system of grading and of elevator receipts is the most important step in the history of the grain trade. It is only with such a machinery that an extension of forward sales in the modern sense is

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<sup>1</sup>See the United States Cotton Future Act.





possible, that is, of forward sales of goods having no definite existence until the moment of delivery. The goods may or may not be in the possession of the seller at the time of the contract. When they are not, and when the seller had made no contract to receive them such a transaction is called a 'short' sale"<sup>1</sup>.

The practice of the "short" selling greatly facilitates the steadiness of price movements and moderates the extreme fluctuations of prices.

3. "Hedging"- "Hedging" is one of the most important functions of produce exchanges. It enables exporters, elevator companies, manufacturers and farmers to protect themselves against losses from price fluctuations. "Hedging" is the device for the insurance of risks of price fluctuations. The man who "hedges" makes a corresponding transaction in the speculative market to offset the actual transaction in the trade market. Professor S. S. Huebner's definition of "hedging" may be quoted. He says: "'Hedging' may be defined as the practice of making two contracts at about the same time of an opposite, though corresponding nature, the one in the trade market, and the other in the speculative market"<sup>2</sup>.

The practice of "hedging" is largely done by exporters of grain and cotton, grain elevator companies and flour millers. It is particularly true that exporters of grain and cotton realize the importance of

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<sup>1</sup>Emery: "Speculation on the Stock and Produce Exchanges". pp. 28-39.

<sup>2</sup>S. S. Huebner: *Annals Amer. Acad.* 1911. p. 24.





"hedging" when they desire to ship a large amount of grain or cotton to a distant place. Supposing an exporter of cotton in New Orleans receives an order of 1,000 bales of "middling" cotton from a spinner in Manchester at 9 cents per pound to be delivered in January. In order to avoid any loss from price fluctuations, the exporter immediately enters the speculative market and buys a corresponding amount of cotton, say at  $8\frac{1}{2}$  cents per pound on March delivery. If there occurs a fall in price of cotton at say 7 cents per pound from any cause, then, he will lose one and a half cents from the "future" transaction, while he will gain two cents from the actual sale. If, however, while the price in the "spot" market advances from 9 cents to 10 cents and the price of "future" contracts advances by a similar amount from  $8\frac{1}{2}$  to  $9\frac{1}{2}$  cents, the loss of one cent on the "spot" market will be balanced by a profit of one cent from the "future" transaction.

Elevator companies or flour manufacturers protect themselves similarly. For example, a flour miller may receive orders for future delivery. He does not desire to buy grain at the present time, so he enters the speculative market and buys a "future" contract. If it be supposed that the price of flour goes down, he may gain a profit out of his actual transaction. On the other hand, he may suffer a loss from his "future" transaction. If the price of flour goes up, the reverse phenomenon will take place. In this case we are assuming that the rise and fall of price in raw material and finished goods of the same material fluctuate together. None the less, this is true in practice. It must be remembered in this connection that there will always be a difference in price of a commodity at different markets. This difference includes transportation charges, other expenses and profit, and is known technically as the



"trade profit".

4. "Arbitraging".- "Arbitraging" is similar in its method to "hedging" although it is quite different in its purpose. It is the practice of making two transactions at about the same time, one a sale and the other a purchase in different markets. The purpose of "arbitraging" is primarily to obtain a profit out of variations in price of a commodity in different markets. The essential requirement for an arbitrageur to be successful is a keen perception of the time element, that is to say, he must know the difference promptly and also must act quickly. A brief illustration may make clear the meaning of the "arbitraging". Supposing a grain dealer in Chicago believes that the difference in price of wheat in Chicago and in Kansas City or St. Louis is really greater than usual or than ought to be. He immediately buys a certain amount of wheat in Chicago and at the same time sells "short" in the same amount of wheat in Kansas City or St. Louis. If the difference in prices between these markets becomes less as the grain dealer predicts, he will gain a profit.

5. "Margins".- It might not be proper to deal with the problem of "margins" as a business method of produce exchanges, but it may be worth while to pay a little attention to its particular relation to "future" transactions. All "future" contracts made on 'change become subject to the rules regulating "margins". Thus "margins" are provided in the rules and regulations of each exchange. A "margin" denotes a certain amount of money put in deposit for the security of "future" transactions. For each transaction the contractors are required to make a deposit of a certain percentage of contract amount. In other words, the seller may





require of the buyer a certain percentage of the contract price, or a deposit of a security and he may require a further "margin" from time to time if the price goes down. On the other hand, the buyer also may require the same amount of money for the same purpose and may demand and addition if necessary.

The Chicago Board of Trade provides a rule for regulating "margins" as follows: "On time contracts purchasers shall have the right to require of sellers, as security, a deposit of ten (10) per cent, based upon the contract price of the property bought, and further security, from time to time, to the extent of any advance in the market value above said price"<sup>1</sup>. The same is true with the purchasers. Further, the rule provides that all securities must be deposited either with the Treasurer or with some banks duly authorized by the board of directors to receive such deposit. In practice, the matter of "margins" is sometimes rather disregarded. Under the condition of full confidence in both the buyer and seller, the calling of "margins" is not common. Nevertheless, when the parties to the contract are not so responsible, then "margins" are required frequently. Sometimes "margins" are called again and again for further security. As quoted above, the Chicago Board of Trade provides that the sellers or purchasers shall have the right to require "margins". Consequently, they do not need to exercise the right unless they so desire. Also the exchange does not require them to do so. The Milwaukee Chamber of Commerce, the Minneapolis Chamber of Commerce, the New York Produce

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<sup>1</sup>Report of the Chicago Board of Trade, 1915. pp. 38. Appendix.



and others provide in their rules and regulations for "margins", the same rules as those of the Chicago Board of Trade.

6. "Privileges", "puts", "calls", "straddles".- We have already discussed practically all methods of business transactions which are exercised on 'change at the present time. There are, however, a number of business practices which are prohibited either by the laws of the states or by the rules of the exchanges. These methods are "privileges" or "option" and "bucketshops". "Privilege" takes several forms such as "puts", "calls" and "straddles". We will discuss them in order.

A "privilege" is a contract which is made under an agreement that the purchasers of the "privilege" can compel the seller to deliver or to receive a certain amount of goods at a certain price within a prescribed time. Professor Emery defines "privilege" as "a contract whereby one party acquires the right, but is not thereby obligated, to buy from or sell to the other party a certain amount of a certain commodity at a certain price"<sup>1</sup>. Sometimes this practice is called "option". It must be borne in mind that the word "option" used here is quite different from the "option" used in connection with "future" transactions. In this case, by "option" is meant that the purchaser of the "privilege" has the right to ask the seller to deliver or to receive a certain commodity, but he is not obliged to enforce his privilege unless he wishes to. On the other hand, by the "option" in "future" transactions is meant that the seller of an article has a right to deliver the goods

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<sup>1</sup>Emery: "Speculation on the Stock and Produce Exchanges". p. 48.





on any day of the prescribed month, but he is obliged to deliver the same before the end of the last day of the month.

The "put" is the "privilege" which gives the purchasers of the "put" the right to compel the seller to receive a certain amount of a commodity at a certain price within a stipulated time. The buyer of the "put" is always afraid that the price will go down. On the other hand, the "call" is the "privilege" which is secured by the purchaser of the same to call upon the seller to deliver a certain amount of a commodity at a fixed time. The buyer of the "call" always predicts that the price of the commodity will go up. A brief illustration may give a better understanding. For example, a dealer of grain, when a certain grain is selling at \$1.05 a bushel in Chicago, believes that it is going much higher. Then he goes to another person to buy the right to "call" upon him for a certain amount of grain within a fixed time at a stipulated price above the market price say, at \$1.10 per bushel. For this right he must pay to the party, say \$0.02 per bushel. If the price of grain goes up to say, \$1.15 per bushel within the time limit, the grain dealer will demand the contract grain at the agreed price of \$1.10. Consequently, the buyer can sell the grain at \$1.15 making a profit of \$0.05 per bushel. Although he must pay \$0.02 per bushel for the right he will still make \$0.03 per bushel profit. On the other hand, if the price of grain goes down to say, \$1.00 without recovery during the time limit, the purchaser will exercise the privilege of not receiving the goods. In this case, he must lose \$0.02 per bushel paid for buying the privilege but no more. The "put" is just reverse to the "call". The "straddle" is a combination of the two forms of "privileges". A "straddle" is a contract by which the purchase of the same acquires the right to exercise





either the "put" or "call" upon the seller within a fixed time at a stipulated price for a certain amount of a commodity.

The price paid by the purchaser of the "privileges" depends chiefly upon the market conditions and the length of time the "privilege" runs. If the market is fluctuating widely the seller of the "privilege" has a greater risk, so he must sell it at a higher price, while steadiness of the market tends to lower the price of "privilege". The duration of the "privilege" is usually twenty-four hours on one week, but sometimes it runs longer. The "privileges" are exercised generally after the regular trading hour, that is to say, they are sold and purchased outside of the "open" market of the exchanges. In a few cases, the "privileges" are exercised by the holder of grain who is afraid of a decline in price before the opening of the market tomorrow. But they are generally sold and bought by the speculators with a desire to gain a profit out of price fluctuation without any intention to deliver or to receive goods. In other words, the "privileges", in a true sense, are useful and they give a great advantage to the holders of commodities, but they are abused widely by the unscrupulous persons. These people exercise the "privileges" simply for gambling, and no legitimate purposes are attached to their use of the "privileges".

7. Clearing house systems.- A few words may now be said regarding the settlement of the balances of numerous transactions made daily on the exchanges. The simplest form of the settlement is the payment of accounts for the "cash" or "spot" transactions. Cash payment and delivery of warehouse receipts are necessary for the settlement of this transaction. No further explanation is needed.



A large volume of trade is carried on in the exchanges by means of "futures" or "short sales". They are somewhat complex in their nature as described before. For example, a certain amount of a certain commodity may be sold and bought by various persons during the exchange hours without actual delivery. Several methods of settlement have been devised and practiced in order to eliminate difficulties and confusions arising from the complex system of the "futures". Today, however, the clearing house system is considered the best method for the settlement of the balances. Most of the exchanges have provided this system. Since the introduction of the clearing house method its importance has been fully recognized by the members of the exchange as in the case of banking business.

A less important system of the settlement of the balances which has been practiced and still is used in minor exchanges where no clearing house system has been provided, is the system of the so-called "ring" or "ringing out". The "ring" method may be better explained by presenting an illustration; e.g., A may sell to B a certain amount of wheat, and then B makes a similar sale to C immediately afterward, and again C may sell to D the same and so on until finally D may sell to A the same. Under this supposition a complete ring is formed among these traders as from A to D. This is the simplest example of this system, and none the less the fundamental principle of the "ring" method is based upon the example just described. In practice, however, it is not so simple as it seems to be. Ordinarily a group of traders form a "ring" in order to settle their balances and each trader in the "ring" may transact several contracts with each other. Of course each transaction may not be represented by exactly the same amount and price. In consequence, difficulties arise





in settlement. However, a majority of the members do not intend either to deliver or to receive the commodities immediately after their contracts are made, but they expect to gain a profit out of their transaction during the time limit. Hence, the members of the "ring" generally settle their balances by simply figuring out the differences, in other words, they find the profit or loss due to each member.

After considering this somewhat unsatisfactory method of settlement, we come to the clearing house system which has been practiced and is considered the most highly efficient method for this purpose. The Chicago Board of Trade, the New York Produce Exchange, and others, have made their clearing house system one of the departments of the exchange. But in the Minneapolis Chamber of Commerce and in the Board of Trade of Kansas City, the clearing house is established as a distinctly independent corporation from the exchange. Therefore, all members of the exchange are not necessarily the members or stockholders of the clearing house. Sometimes we find that the settlement of the balances among the members of the exchange is performed through a particularly designated bank. This is the case in the New York Cotton Exchange which has a special arrangement with a particular bank for this purpose.

The process of the settlement through the clearing house is primarily the same as in the case of the banking business. Each member of the clearing house must send confirmation slips or memoranda to the clearing house each day stating the date of transaction, quantity and kind of commodity, the month of delivery, the price and the name of the party, with his signature to confirm the transaction. On the Chicago Board of Trade such memoranda must be sent to the clearing house by 6:00 p.m.



on the same day, while on the New York Produce Exchange such memoranda must be sent before 9:30 a.m. on the following day. Furthermore, each member is required to keep a settlement book in which all the details of contracts to other parties are stated, such as the name of the parties, the dates and terms of the trades, the amount due to or from him or them on each separate settlement, and the net amount due to or from him or them. Lastly, he must make reports to the clearing house, showing the net balance due to or from each member. Such reports must be accompanied with an acceptable check for the aggregate of balance<sup>1</sup>.

At a stated hour each day the clearing house, then, pays to each of the parties any balances due to him upon the examination of all the reports submitted. As a matter of fact, the clearing house is nothing but the place where each member cancels his accounts, that is to say, clears differences.

However, the clearing house association of the Minneapolis Chamber of Commerce and of the Board of Trade of Kansas City perform not only the cancellation of differences for each member, but also the clearing of grain. The clearing house in these exchanges upon the receipts of the reports from each member makes a record of these reports showing each member whether he is "short" or "long" for each transaction. Also the clearing house requires "margins" for all trades and further additions may be demanded according to the fluctuations of prices.

It must be noted in this connection that the daily settlement of differences is based upon the current market value of the commodity in question. This important matter is provided in rules of each exchange.

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<sup>1</sup>Report of the Chicago Board of Trade, 1915. p. 54.



It is absolutely necessary to fix some standard price for the settlement owing to the variety of contract prices. The Chicago Board of Trade provides in its rules that "the current market value of the property contracted for shall be conspicuously posted, at a stated hour each day, under the direction of the Board of Directors, in the Exchange Hall and in the settlement rooms of the Board, which posting shall serve as a basis for the adjustment of all contracts settled, as herein provided on that day"<sup>1</sup>.

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<sup>1</sup>Chicago Board of Trade, Report of 1915. p. 54.





## CHAPTER IV

### ECONOMIC FUNCTIONS OF PRODUCE EXCHANGES

In this chapter our efforts will be directed chiefly toward the justification of the functions of the produce exchanges from the economic point of view. The economic functions of produce exchanges may be enumerated under four heads as follows:

- (1) Produce exchanges facilitate and regulate the distribution and production of commodities;
- (2) They tend to moderate the fluctuation of commodity prices;
- (3) They furnish a continuous and more general market;
- (4) They facilitate the operation of trade and reduce its risks.

Each function will be taken up in turn.

The primary purpose of the distribution of commodities, of course, is to direct the surplus products of a people, community or country to those who are in need of such surplus products, and to distribute the products among the consumers in the least possible time and with the least expense. In other words, these products should be distributed to the most advantageous points where goods will yield the highest market value. With the creation of the enormous surplus in agricultural products in the 19th century in this country and some other countries, a world market was required for their prompt and proper distribution.

To accomplish this purpose, the exchanges are situated in large cities where many people are in need of agricultural products, and where the transportation and communication facilities are abundant; that



is to say, the exchanges are so located that the producers and middlemen are enabled to bring their goods to the most advantageous place, and at the same time the consumers are benefited by having their needs satisfied with the least trouble and at cheaper prices.

For producers the exchanges are an indispensable means of affording a reliable guidance to production. Publicity and information of all sorts given by the exchange concerning agricultural and other commodities enable the producers to center their efforts, labor and capital on the production of such articles as will have the greatest market value. Further, knowing the tendency of their market value the producers are enabled to forecast the future demand of many articles. From an individual point of view, the production and distribution of commodities are simply for exchange. The markets, accomplishing this purpose, create the places where the people can exchange their products for the goods of others. The exchanges, accordingly, are established in large cities. In order to facilitate distribution and also production of commodities the exchanges provide proper rules and regulations for not only their own members, but also for those who are interested in the business of the exchanges. Finally, the exchanges are not established for the interests of buyers or sellers exclusively, but for the interests of buyers, sellers, producers and consumers alike. To consumers the exchanges give cheaper goods than otherwise would be possible, because they eliminate the expenses of numerous middlemen, reduce the cost of transportation, and give better and reliable goods by providing for inspection, grading and weighing systems.

A second function of produce exchanges is to moderate the





fluctuations of commodity price. In the early stages of society the price of one commodity was largely dependent upon local conditions. The market price of a commodity, on the theory of demand and supply, is most simply determined under these conditions. A poor crop of grain in one year in a certain place affects largely the price of grain in that locality. This was the phenomenon which was seen in early days when the production of agricultural products was in its infancy and transportation and communication facilities were undeveloped. But today, by means of transportation and communication, the prices of most of the leading cereals are determined in a national or world-wide market. Now, only a few minutes of time is necessary to know the prices of commodities on any exchange, and a few days is sufficient to transport goods from one place to another even in a vast country like America. In modern business, as a matter of fact, a favorable or unfavorable condition of a crop in one locality or country may be so balanced by the opposite condition elsewhere as to render worthless a price quotation based merely upon local evidence. Of course this may not be the case if a commodity is produced under the condition of monopoly.

Produce exchanges are the most closely related mediums for the distribution of commodities from one place to another; they are familiar with crop conditions in various parts of the country and of the world, movements of grain and other commodities and changes in freight rates. Thus, price fluctuations are greatly reduced.

Through or by the process of speculation, the price of commodities are moderated and tend to keep an equilibrium, for the constant contest between the judgments of the "bulls" and the "bears", who have



entirely opposite intentions, brings about a truer level of prices than could otherwise exist. Professor Emery in this connection states that: "Speculation acts to concentrate in a single market all the factors influencing prices. In this way a single price is fixed for the whole world. By means of arbitrage transactions former differences of price in different markets have been leveled"<sup>1</sup>. Further he says: "Perhaps the most potent influence in preventing wide fluctuations is the much maligned short-seller. It is he who keeps prices down by his short sales, and then keeps them strong by his covering purchases. ....On the other hand, when prices begin to tumble, they are kept from going so low as they otherwise would by the purchases which the shorts had to make to cover their contracts. Thus prices at both ends of a panic are less extreme than they would be without short selling"<sup>2</sup>.

A third function of produce exchanges is to furnish a continuous market. As the exchanges furnish places for buyers and sellers to transact their business throughout the year, there is a great advantage for the producers, grain dealers, manufacturers and others. The features of a continuous market is that it affords farmers, bankers, speculators and manufacturers opportunities to insure their risks in so far as a market gives positive assurance to all holders of commodities, such as grain and cotton, that, in case of necessity, they are able to dispose of their goods at approximately the prevailing price at a moment's notice<sup>3</sup>. For the farmers or producers the continuous market

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<sup>1</sup>Emery: Speculation on the Stock and Produce Exchanges. pp. 120-121.

<sup>2</sup>Ibid.

<sup>3</sup>Annals of the American Academy of Political and Social Sciences. Vol. 38. p. 14.





for their products serves as a means of obtaining credit, for they can borrow funds against their crops more easily even though they do not possess warehouse receipts. The traders, mostly, elevator companies and brokers advance money freely against crops because they can keep themselves "hedged". For traders and speculators, the continuous market gives them not only easy disposal of their goods, but opportunities to readily borrow funds from bankers upon warehouse receipts as collateral. This is because bankers can convert the commodity into cash at any time when necessary. Thus the continuous feature of a market renders a great benefit by facilitating the production and distribution of agricultural products.

Some of the manufacturers oppose "futures" on the ground that they could buy raw materials at better rates during harvest. But better prices to the manufacturers mean poorer prices to the producers. Without the method of "future" transactions, manufacturers would have to buy at higher prices for several months preceding the harvest time. Moreover, they would have to keep a large stock for the whole year's work. This is a great risk to the manufacturer. "Futures" and a continuous market greatly avoid the great risk for the manufacturers and enable them to run at full capacity all the time, with a profitable price for the raw products and without any serious risks.

Professor Emery says, "without the possibility of hedging, the uncertain conditions of wheat and cotton buying would at times cause a complete cessation of actual trader's demand. Nothing is so effective in doing away with gluts as the continuous market in which the dealer may always dispose of his holdings to speculators if he fears a fall"<sup>1</sup>.

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<sup>1</sup>Emery: Speculation on the Stock and Produce Exchanges. p. 169.





As a fourth function the exchanges facilitate trade operations in a great degree not only by providing rules and regulations which supervise the conduct of members in business, but also by means of inspection, grading, weighing, and storing which are supervised and regulated by strict rules either by the state authorities or the exchanges. The rules and regulations regarding "hedging", "margins", standard weights, qualities, etc., operate for the benefit of not only the members of the exchanges, but also the producers, consumers and middlemen. In some of the states like Illinois, Minnesota and Missouri, some of these functions are performed by the state authorities, but in others they are handled by the exchanges.

In concluding this chapter, the following three points may be quoted from the report of the Industrial Commission of 1901<sup>1</sup>: (1) "They (exchanges) localize industrial risks among a commercial class whose special function it is to distribute surplus supplies over deficit times and places in such a way as to lessen the uncertainty of producers and consumers; (2) they relieve producers and consumers from carrying a whole year's stock, enabling the farmer to convert this crop promptly into cash capital and the latter to supply himself as his periodical need may require without enhancing prices beyond the ordinary rate of risks and returns of such capital investments; and (3) competition of speculative dealers tends more than any other force to reduce profits

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<sup>1</sup>U. S. Industrial Commission Reports. Vol. I. p. 29.



of these agencies to a minimum per unit of commodity handled. Released from other economic functions, it is to their interest to seek to reduce the risks of distribution to a minimum. By expert acquaintance with the conditions that involve risks the hazardous elements are gradually limited if not entirely eliminated."





## CHAPTER V

### THE ORGANIZATION OF PRODUCE EXCHANGES IN JAPAN

#### A. The Early Japanese Produce Exchanges.

The speculative spirit and love of gambling have been inherent to human nature in the East as well as in the West. Americans are considered the most speculative people; so believe the Japanese. It is curious and interesting to know that, in Japan, produce exchanges had existed for centuries previous to the introduction of the new western civilization about fifty years ago.

A brief discussion of social classes in Japan between the 16th and the middle of the 19th century is important in order to understand the real situation when the exchanges came into existence. During this period there were four distinct social classes: (1) "Shizoku" or "Samurai", those who belonged to the militaristic families; (2) "Nomin", farmers; (3) "Komin", those who were engaged in industrial pursuits other than agriculture; (4) "Shomin", merchants. Governmental activities were performed exclusively by the "Samurai" class in the central provincial and local governments excepting in a few instances. This class had peculiar powers and privileges of supervising and controlling the other classes. The chief idea or the prevailing sentiment of the "Samurai" class was primarily to develop mental, spiritual and physical culture. Honesty and loyalty to the superior was a stern duty required of every "Samurai", even to the sacrifice of life and property. The "Bushido" spirit characterizes the people of this class. "The flower is the cherry and man is the 'Samurai' was the plausible expression of praise for this class during the feudal period. The people of this class, however,



were almost utterly ignorant in respect to business affairs. The class of the "Nomin", because of its importance, was considered next to the "Samurai" rank and was really the chief supporter of the nation. Industry other than agriculture was in its infancy. There were hardly any factory enterprises, and handicraft production prevailed extensively. The fishing and silk manufacturing industry may be considered the most important. Merchants were the lowest class and were considered dishonest by the other classes.

Under such social conditions, the exchanges were first organized in Japan in this period. Their importance as an economic factor, however, was more recognized in the later than in the early part of the period. As a matter of fact, the highly developed commercial and industrial corporations had not yet been introduced, so that only agricultural commodities were subject to speculation. Further, during the entire period rice was the chief article for speculation. Oil, cotton goods and some other commodities were sometimes bought and sold on the exchanges but in insignificant amounts.

The chief reasons for the wide use of rice as the subject matter for speculation were that rice was the largest product of the farms, that at the same time it was the essential factor in living, and that taxes as well as the salaries of officials and serfs were paid in this commodity. Consequently, rice was the important standard of measurement for national wealth. Favorable and unfavorable crops and the consequent high and low prices of rice directly affected the prosperity of the central government, lords and all "Samurais" as well as the farmers. In fact, the relation of rice culture to the people of Japan at that time was much more important than it is today.





Under the circumstances which prevailed during the latter half of the feudal regime, the central government<sup>1</sup> controlled the prices of rice artificially. The prime purpose of this governmental policy was to eliminate the wide fluctuations of prices. It considered this its fundamental duty not only for the benefit of itself and the "Samurai", but also for the welfare of the public as a whole. This policy had two distinct phases of raising and lowering prices.

Several methods had been devised in order to raise the prices. Occasionally the central government arbitrarily fixed the lowest price and forced people to follow this order to prevent a considerable decline in price. Another method practiced was that of the arbitrary control of a large supply of rice by the government and the lords. Still, another device often followed was the limitation of the amounts and fixation of definite times for rice shipments from the producing districts to the important cities such as Tokyo, Osaka, Kyoto. Lastly, a most important consideration was the recognition of the speculative transactions by the central government at various places.

On the other hand, the government provided several methods by which it lowered and also prevented unusual rises in prices. In the first place the government prohibited, whenever necessary, the forestallment of a large quantity of rice on the part of the traders and manufacturers. In the second place, when the price of rice rose too high the government discontinued its prohibition of the shipment of rice. Thirdly, relief was occasionally granted by the government by giving a supply of rice to the poor.

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<sup>1</sup>The "Tokugawa Shogunate" had controlled the entire empire of Japan for three centuries.





From the foregoing discussion, it may be concluded that the policy of raising the prices was obviously devised primarily for the benefit of the "Samurai" class including the "Tokugawa" government itself and the farmers.

The policy of lowering the prices was apparently taken on behalf of those who were engaged in industry and the poorer people, contrary to the interest of the "Samurai". It was inconsistent for the government to use methods of lowering the prices which led to unprofitable conditions for the "Samurai". This fact was particularly shown in case of a famine when the farmers and those salaried people suffered great inconvenience from lowered prices. The government, however, had to pay close attention to the fact that in view of its social and political situation, it was absolutely necessary to relieve the poorer classes in case of famine. Disorder and rebellion could only be avoided in this way.

We come now to the discussion of the actual conditions which prevailed in the exchanges. The right of establishing the exchanges in various places was granted by either the central government or a particular lord in each locality. They were organized under a feudal control. There was no general and uniform system of organization. Each exchange was established and controlled under the direction of each particular lord who had absolute power over his community. In consequence, the types of exchanges were quite diversified. A general understanding, however, can be obtained by the discussion of a particular exchange, namely the Dojima Rice Exchange in Osaka, which was considered the oldest and largest exchange at that time.



The Osaka Dojima Rice Exchange was the immediate successor of a rice market known as the "Yozoya Komeichi" which was organized by an individual merchant named "Yozoya" during the early part of the 17th century<sup>1</sup>. This exchange was recognized as a market place for rice. Since the speculative transactions were officially recognized by the government in this exchange during the period of Kyoho (early part of the 18th century) the exchange and its rice transactions became more and more important<sup>2</sup>. As the volume of transactions increased, the merchants felt much inconvenience because of the necessity of the actually transferring commodities within the exchanges. Hence a kind of certificate known as the "Kurayashiki Kitte" which designated the amount and kind of rice similar to the warehouse receipts at the present time, was devised in order to facilitate their transactions. The new device was a great convenience for the merchants because they could transfer these certificates without any actual delivery or presentation.

Notwithstanding the use of the rice certificates and the consequent stimulation of transactions on the exchanges, the significance of speculation could not be realized fully until rice standards were adopted in the exchange during the latter period. Sometime later, the houses known as the "Yarikuri Ryogaeya" which were similar to the clearing houses of today, came into existence. The function and business of these houses were to keep accounts for the traders, to clear transactions and to charge a commission for the service. Private concerns exclusively

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<sup>1</sup>Exchanges and Speculation. By Prof. Z. Sano. p. 68.

<sup>2</sup>Ibid., p. 68.





managed these houses which were primarily organized with a view to facilitate the transactions of the exchange and to realize a profit from them.

The location, organization and management of the exchange differed from that of the present exchanges to a large extent. There were numerous brokerage houses along the main street at Dojima, and in the middle of the street at Dojima there was the place where the brokers transacted their business daily and which was called the "Yoriba". The management of the exchange was under governmental supervision in a different building known as the "Kaisho". The functions of the "Kaisho" resembled those of the present exchanges. Supervision and regulation of the brokers, settlement of disputes and the supervision of the public quotation were the chief functions of the "Kaisho".

Officers of the "Kaisho" were the "Nengyoji" and "Kayaku" who were elected by the brokers among themselves. Especially the "Nengyojis" were considered important officers. After they were elected as "Nengyojis", they were subject to the approval of the governmental authorities. At the same time those brokers, who had been elected, were obliged to abandon their business as brokers owing to the governmental rule requiring them to supervise and regulate the business of the brokers. The "Kayaku" were also elected by the brokers and were the assistant officers of the exchange.

The business methods of the exchange may be classified as the "cash" and the "future" transactions. Under the "future" transaction two separate methods were used: one called the "Chomai torihiki", (transactions in book accounts) and the other, the "Kokutatemai shonai", (transactions in standard rice). Both in the "Chomai torihiki" and the



"Kokutatemai Shonai" transactions, the several standards of rice were fixed annually by the brokers, and the minimum contract amount was one hundred koku corresponding to about five hundred bushels. The contract price, however, was based on one koku, about five bushels. There were three contract dates for the "Chomai torihiki" as April 27, October 8, and December 23<sup>1</sup>. The "Kokutatemai shonai" transaction differed from the "Chomai torihiki" only in consideration of the length of period for which contracts ran. In the former transaction the periods were fixed at either one or two months, that is to say, the transaction was either a one or two month contract.

On the other hand the "cash" transactions were carried on in the exchange although the volume compared with that of the "future" was insignificant.

Concluding the history of the produce exchanges in early days, it can be said that the chief article dealt in on 'change was rice. The peculiar position of rice as the chief article of diet, coupled with governmental policy as to its price, made it very important. It seemed that the government as well as lords were well satisfied with the result of the policy practiced during the period, irrespective of economic justification of such arbitrary policy. The organization of the exchanges was rather simple but different in each exchange. Speculative transactions increased rapidly after the official recognition was granted by the government. The number of exchanges as well as the amount of

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<sup>1</sup>"Exchanges and Speculation": by Professor Z. Sano. p. 85.



speculative transactions continued to grow with occasional interruptions by the government before Commander Perry first visited Japan.

B. The Present Japanese Produce Exchanges.

Japanese produce exchanges are the outcome of centuries of evolution although they attained their present significance with the introduction of the new civilization. The most conspicuous feature of the exchanges is the organization. Almost all the exchanges, produce as well as stock, are organized as corporations with capital stocks. In consequence, the prime purpose of the exchanges is to secure profits for the benefit of the shareholders. Only two of nearly fifty exchanges are organized with no capital stock and with systems of membership similar to the American produce exchanges<sup>1</sup>. These two exchanges are formed primarily for the mutual interest of the members. Another characteristic of the exchanges is the fact that they stand as permanent contracting parties for all traders, and therefore, the brokers are required to deposit a security for each transaction. Under a special law, the exchanges must guarantee and be responsible for the transactions.

Among the distinctive merits of the Japanese exchanges is the fact that there can be no loss occurring from any misdemeanors, because the exchange gives a guarantee against such losses. Consequently, any party will be free from his responsibility as soon as he makes his account with the exchange without any settlement whatever with the contracting

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<sup>1</sup>Japan Year Book, 1913. pp. 344-5.





parties. The exchange is naturally in such a position that it has to supervise the actions of the brokers, because the direct interests of the exchanges and the brokers may differ from each other. Further, this type of exchange offers the public an opportunity for investment.

On the other hand, the organization of the Japanese exchanges has been much criticized. This criticism is caused largely by the general lack of confidence in brokers. Those exchanges organized under the system of membership like the American exchanges, are established for the mutual benefit of each member, and also are established upon the principle of personal confidence among the members. While in the Japanese exchanges personal confidence is wanting and at the same time as the exchanges are organized for profit, they desire that there shall be a large number of brokers transacting business on 'change. But this incentive for profits works against a careful consideration of the integrity and business standing of those who are associated with the exchange. In short, the criticism of the Japanese exchanges has been occasioned chiefly on account of the general lack of confidence in brokers, and the fact that the exchanges are organized principally for profits. Brokers also consider that the profit basis of the exchanges is detrimental to their interests.

It can be assumed that, theoretically speaking, the organization of the produce exchanges or similar institutions under the membership plan must be far better than the plan of the stock corporation. However, we must take into consideration the particular circumstances of a particular society. The history of the Japanese produce and stock exchanges gives strong evidence that the membership system has been unfitted for the past conditions of the society and is still unfitted for the present.



More than once in the past, the plan of membership has been adopted for produce as well as stock exchanges in various places, but it was an utter failure. At the present time, there are very few produce exchanges existing under the membership system. However, those exchanges as stock corporations are numerous. At one time, over one hundred exchanges existed under the stock plan. Although their number has been decreased, the present number of this type of exchanges is about fifty<sup>1</sup>.

The question naturally arises in our mind why such a large number of exchanges is established under a system less beneficial for the public as well as for the traders. The answer is to be found in the study of relations of the feudal classes in old Japan, which has been mentioned previously. Agriculture, only, was a noble occupation except the "Samurai", and commercial dealings were looked upon with great disapproval by the higher feudal classes. Business, in the modern sense, was ignoble and those engaged in it were members of the lowest social class and were considered both intellectually and morally inferior. It was particularly true with those who were engaged in speculative business. Moreover, there prevailed a sentiment that persons who were speculators, were likely to do something which might harm others. Under such circumstances merchants in these days admitted themselves that they belonged to the lowest class.

Notwithstanding, the fact that all possible improvements and changes have taken place in social, economic, educational, religious and other directions since the new era, the long continued sentiment of

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<sup>1</sup>Dr. Z. Sano, "Exchanges and Speculation". pp. 390-391.





distrust of merchants has not yet been entirely swept away. Still, there is a great necessity for confidence in merchants if Japanese business is to obtain the greatest development. This is the chief reason for the unfavorable situation of the membership plan in Japan. However, new and special attention has been carefully directed toward the uplifting of commercial confidence and the general standards of business men. Today, businessmen are the most intelligent and able as well as wealthiest members of society. The future of the business interests appears prosperous and bright.

Japanese produce exchanges are classified according to the articles dealt in, for instance, exchanges for rice, oil, general merchandise, cotton goods and silk goods, etc. A majority of the exchanges are organized for the purchase and sale of agriculture products, particularly rice. On some of the exchanges, both agricultural products and securities are bought and sold similar to the European Bourses. Under the present law regulating the exchanges, a capital of 100,000 yen is necessary for the organization of a produce exchange. And also the exchange can not commence its business until one-half of the capital amount shall have been paid. Previous to the present law which took effect in 1903 the amount of capital required for the establishment of an exchange was fixed at 30,000 yen<sup>1</sup>. In consequence of the new law, since 1903, the number of the exchanges has been decreasing, and for the last ten years, the number has been in the neighborhood of fifty.

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<sup>1</sup>Dr. Z. Sano: "Exchanges and Speculation". pp. 396-397.



By law, the exchanges are required to investigate the financial standing of brokers and to act as a medium in securing government licenses for them. They are also required to provide a standard grade for each commodity dealt in on the the exchange. Price quotations must be posted daily by each exchange. Not only for the management of the exchange but for the benefit of the brokers, the exchanges are required to establish necessary rules and regulations. Fines are provided for any violation of these rules and regulations. A guilty broker may be suspended or expelled by any exchange under the law regulating their business.

Furthermore, there are several necessary requirements for the exchanges such as keeping accurate records of all transactions, the dates of transactions, amounts, prices and kinds of commodities, estimations of securities, which shall be required for each transaction, commissions on transactions, supervision of delivery and payment of commodities, and arbitration of disputes among the brokers.

Under governmental supervision the exchanges are obliged to make a report to the Minister of Commerce and Agriculture of such matters as daily price quotations, monthly amounts of transactions, monthly statements of the movements of commodities, the estimations of incomes and expenditures for each half year, the statements of property, profits and losses, and the names of shareholders, brokers and employees.

The government of the exchange is vested in the hands of a general manager and two or more assistant managers. A few auditors are usually provided as a safeguard of the financial management of the exchanges. These officers are generally elected by the shareholders annually, and the terms of office are one or two years. In every case, governmental approval is a requisite for the inauguration of such officers.





The qualifications of the general manager and assistant managers are provided in the law regulating the exchanges. The Dojima Exchange provides that the general manager and assistant managers must hold not less than 40 and the auditors not less than 20 shares of stocks. Officers and employees of the exchanges except the auditors are prohibited from transacting any business on the exchange.

Brokers are the only persons who are allowed to transact business on the Japanese exchanges. There are more than one thousand brokers for all the exchanges, and the total amount of their bonds or securities were estimated at about five million yen in 1911<sup>1</sup>. Brokers must be over 25 years of age and must have had at least two years' experience in a similar line of business; i.e., each broker must have been engaged in a business which deals in the same kind of articles bought and sold on 'change. As stated before the broker must have a license which can be obtained through the exchange from the government upon a written application to the Minister of Commerce and Agriculture. The exchange sends with each application the references of the applicant. Then a license may be given by the government upon payment of one hundred yen, and upon filing a sufficient bond with the exchange.

Prevailing methods of business are practically the same as those of the early days, which we have already described. Three different transactions are carried on as: (1) "Jiki" transaction ("spot" or cash);

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<sup>1</sup>Exchanges and Speculation. By Dr. Z. Sano. p. 408.





(2) "Nobe" transaction; and (3) "Teki" transaction ("future").

As defined in the laws, the "Jiki" transaction is equivalent to the "cash" or "spot" transaction in this country, in which the delivery of commodities takes place within a short time and the transaction is based on samples. The "Teki" transaction may be defined as a contract made by brokers with an agreement of delivery and acceptance of a certain amount of a certain commodity at a stipulated price within a prescribed future time. It is the same in nature as the "future" transactions of the American exchanges. However, the law provides that such transactions must be completed within three months after the transaction is made. The "Nobe" transaction is supposed to be an intermediary between the two above described and is considered as a cash transaction. The law provides that such transactions must be fulfilled within 150 days and no allowance is made in such transactions regarding the "pit" as in the case with the "futures". As a matter of fact, the "Nobe" brokers are actually following the same practice as in "futures". In many cases, no actual delivery of contracted articles takes place at the fixed date. Instead of delivering the goods at the time limit, the brokers make an agreement that the contract will be postponed until a new definite future time. In this agreement the commodity shall be borrowed and the money loaned by the seller and the reverse action taken by the buyer. The underlying purpose of this agreement is obvious and is due to the fact that both the seller and buyer desire a profit out of the anticipated changes in price.

This practice has been much discussed and criticized as a gambling device or at least a gambling spirit dominates in the minds of those who engage in such transactions. At any rate, it can be said that



such transactions should be considered illegitimate so far as the basic idea of the laws governing the exchanges is concerned. The laws provide for the "future" transactions a certain amount of security and a tax, while no such provision is made regarding the "Nobe" transaction, on the ground that the "Nobe" transactions are identical with the "cash" transactions in nature and practice. The fundamental difficulty relating to this transaction is that the present laws can not prevent the brokers from performing such contacts. The question, however, must be solved by the brokers themselves, or it can be easily solved by appealing to the broker's feeling of justice.

In the "Teki" transaction which has predominated, the contract amount, the contract grades and the standard of contract prices are fixed by the exchanges. The Osaka Dojima Exchange provides that the minimum contract amount be one hundred koku. The contract grades are for the domestic rice, the "Settsu nakamai"<sup>1</sup>, and for the foreign rice, and the Korean rice; while the standard of contract price is based on the price of one koku. Contracts are drawn up on three bases with respect to the time element, current month, two month and three month contracts.

As elsewhere stated the security demanded by the exchange for each transaction varies with the amount of the contract. Additional security may be required with the fluctuations of prices as in case of the American exchanges. The Dojima Exchange provides that from two to thirty per cent of the contract price will be charged for each security and it must be paid before the closing hour of the exchange each day.

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<sup>1</sup>Exchanges and Speculation. By Dr. Z. Sano, p. 429.





A commission charge is also made for each transaction by the exchange. The rate of the commission, however, is determined not by the exchange, but by the government. The rate must not be more than 8/10 of one per cent of the contract price<sup>1</sup>.

A large volume of transactions made on the exchange under the contract of the "Teki" are not followed by the actual delivery of commodities. Under the exchange laws, the so-called "Tembai" and "Kaimodoshi"<sup>2</sup> are recognized only in case of the "Teki" transactions. Thus the "Teki" transaction is practically identical with the "future" transactions of the American exchanges. In "cash" transactions the delivery of commodities is accomplished by the means of the transfer of warehouse certificates which correspond to the warehouse receipts in this country. In the "Teki" transaction the delivery takes place on the last business day of the month. Generally, the settlement of delivery is made through banks in which brokers have their accounts.

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<sup>1</sup>A certain kind of rice which is produced in a locality called "Settsu".

<sup>2</sup>"Tembai" means resell; "Kaimodoshi", repurchase.



## CHAPTER VI

### CONCLUSIONS

From our brief discussion of the American and the Japanese produce exchanges, we may conclude that the organized produce exchanges, in spite of their comparatively short history, have become an indispensable economic institution under our present highly organized social and economic system. They are only one of the manifestations of the application of man's effort and skill to create organizations for the better satisfaction of his needs.

Although the exchanges are established primarily for the direct interests of the traders and members of the associations, nevertheless, they also confer benefits upon the public as a whole. It is undeniable that the exchanges form the best agencies for the public to obtain reliable information concerning the value of agricultural commodities. Also they afford the producers a safer and easier means for the disposal of their products; and, for the consumers, they make possible cheaper and more reliable goods. They aid greatly the promotion of commerce and trade. Competition, which is fully realized in the business of the exchanges, brings about the best possible and truest value of commodities. Further, the American produce exchanges are not established as profit making organizations. Consequently, it may not be an exaggeration to say that the organized produce exchanges are in their purpose and functions, established not only for the traders and members exclusively, but for the benefit of the whole community. The public interest in the exchanges, therefore, is vital and indispensable.



On the other hand, it must be borne in mind that although the existence of the exchanges is absolutely necessary to our economic and industrial activities, there are many considerations which the public ought to understand carefully, in order to appreciate the true benefit of the exchanges. Primarily, the exchanges are not places where large gains can be secured in a moment, as they sometimes are looked upon by the public. They are organized to permit members to perform desirable economic functions. Even though the immediate purpose of the traders and members of the exchanges is to gain profit, the fundamental principle underlying their activities, or the chief purpose of the exchanges, is to perform economic functions which advance the public welfare. However, the mysterious nature and complex methods of business often give the public erroneous and dangerous impressions. In other words, the possibility of making quick and large profits and the need of a comparatively small capital leads those who have no knowledge or experience concerning speculation to engage in trade operations. These people are gambling on the exchanges, and their success or failure depends chiefly upon mere chance. Their efforts contribute nothing to the public welfare but tend to demoralize it.

To be a successful broker in the exchange requires a thorough knowledge of economic problems and skillfulness in trade. Every person is not qualified for such an occupation and it must be left to that group of people who are particularly trained and fitted for such complex and intricate business. Under their direction with proper regulations the exchanges can best fulfill their public functions. However, the public must understand the true nature of the exchanges and must permit the greatest development consistent with public welfare.





Since the relation of the exchanges to the public has become very important and there have been some undesirable features in their activities, the public ought to provide regulations to remedy the evils. Realizing the true nature of the exchange as a public economic institution, most of the states in the Union have provided laws regulating them, and, at the same time, the exchanges themselves have strict rules and regulations for not only the management, but for the conduct of business operations. Owing to the peculiar nature and importance of the exchanges, the public regulations have become more and more necessary. Thus, exchanges are regulated by the general corporation laws as well as by the laws regulating the commerce of a state. Besides the regulation of the exchanges as business corporations, there are several laws provided to prevent certain kinds of business activities on 'change. The "bucket shop" and "corners" are, for example, prohibited by law in almost all the states where there are exchanges<sup>1</sup>. The "pits" and "calls" are also forbidden in most of the states. The "futures" and "short sales" have been considered in some states as illegal transactions, and are prohibited in most of the southern states except Louisiana.

Not only does the public regulate the management and business methods of the exchanges, but it also regulates and supervises the warehouse and inspection systems which are indispensable to the business transactions of the exchanges. As previously noted, the warehouse and inspection systems afford a very valuable service to the public and facilitate the activities of the exchanges. The warehouse system in each

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<sup>1</sup>The state of West Virginia is an exception actually having a law licensing and permitting the operation of "bucket shops". Carl Parker, Columbia Univ. A.A.A. Vol. 38. p. 148.



state is placed under the supervision of some public commissions, such as the warehouse and railroads, or public utility commissions. The inspection or grading system has become a public function in many states especially in the middle western states. Hence, many states have established a state grain inspection department. It is beyond question that these functions performed by state authorities give great conveniences and benefits to the traders as well as to the public.

In recent years the federal government has taken several steps toward the regulation of the exchanges. Several bills have been proposed in Congress session after session to suppress the speculative transactions such as "futures", "margins", and "short sales", particularly "options". The "anti-option" bills have been introduced by such men as Betterworth of Ohio, Hatch of Missouri, Berry of Arkansas and several others. Most of these bills were introduced by those who represent the western and southern states. Mr. Carl Parker says in this connection: "It is probable that the question will continue to come up for some time, until the western and southern states, from which the protests chiefly come, reach a higher level of commercial and economic education"<sup>1</sup>.

The first real federal regulation of the exchanges was realized when the Cotton Futures Act of the United States was passed in August, 1914, and became effective February 18, 1915. This act regulates the cotton trade of this country. Its chief purpose is to eliminate the evils of speculation and to make uniform the conditions of the cotton trade throughout the entire country. The main features of this act are

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<sup>1</sup>Carl Parker, A.S.A. Vol. 38, 1911. p. 144.





a tax of two cents per pound of cotton unless actual delivery is made or unless the contract conforms to the several specified requirements, and a determination of the "spot" quotations for the settlement of differences. Several specified requirements for the exemption from the tax are: that the contract must be in writing stating the terms of such contract and must conform to the rules and regulations made, pursuant to the act; that names and addresses of the sellers and buyers must be specified; that the quality and quantity of the cotton involved in bales of pounds must be stated; and that the contract must specify the basis grade for the cotton involved in the contract as established by the Secretary of Agriculture<sup>1</sup>.

Still a more recent governmental regulation took effect when the United States Grain Standards Act was passed in August, 1916, and became effective December 1, 1916. This act was passed for the prime purpose of obtaining uniformity in the grading and inspection of grain for interstate or foreign trade and for the purpose of facilitating trade operations. As previously discussed the inspection and grading of grain in each exchange are performed under either the state authorities or the exchange. The differences in grading systems in various states and exchanges caused many difficulties and much confusion in interstate commerce of grain. In order to avoid such difficulties the act provides several rules; and it says in part: "Whenever standards shall have been fixed and established under this act for any grain, no person thereafter shall

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<sup>1</sup>See: The United States Cotton Future Act.



ship or deliver for shipment in interstate or foreign commerce any such grain which is sold, offered for sale, or consigned for sale by grade unless the grain shall have been inspected and graded by an inspector licensed under this act"<sup>1</sup>.

There are several provisions in this act relative to such inspectors. An inspector's license may be obtained from the Secretary of Agriculture upon a presentation of satisfactory evidence that such person is competent, to inspect and grade grain and to certify the grade for shipment of grain in interstate or foreign commerce. Such an inspector, licensed under this act, is required to keep complete and correct records of all grain graded and inspected by him, and to make reports to the Secretary of Agriculture.

We have already said that public regulation is necessary when the exchanges become detrimental to the public welfare. But it is not reasonable to regulate or suppress the exchanges to an extent which will destroy the true functions of these important economic institutions. The best illustration of the extreme governmental regulation toward speculative transactions and its ultimate effect can be noted in the German experience during the latter part of the 19th century. The German Exchange Act of 1896 was passed to destroy "future" transactions in grain, prohibiting all exchange dealings for future delivery in grain and flour, and also all exchange delivery on account in the shares of mining and industrial companies<sup>2</sup>. The result was that the traders and brokers

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<sup>1</sup>U. S. Grain Standard Act. p. 51. Rules and Regulations of the U.S. Grain Standard Act.

<sup>2</sup>See: Annals of Amer. Acad. of Political and Social Sciences. Vol. 38. pp. 136-40.





withdrew and there was no "open" market and consequently no quotations for agricultural commodities or for securities. As a result no one had any trustworthy price basis and the producers as well as other persons felt a great inconvenience.

Most of the criticisms of exchanges relate to the speculative transactions, particularly, "futures", "options", "bucket shops" and "corners". It may be said that the criticisms often made are centered on the following three points: (1) speculation is a gambling device; (2) speculation lowers prices; and (3) speculation raises prices.

To distinguish between speculation and gambling is a difficult problem and the line of separation is hazy. The element of risk is the essential factor in both cases. There are, however, several distinctions between the two, which have been suggested by many writers. It is said that speculation is based on some control and foresight of the event, while gambling is not, and the former is economically justifiable while the latter is not. Professor Emery's view on this question is that "speculation is a contract in buying and selling of property in the hope to gain profit out of anticipated fluctuations in prices and gambling is the event upon which one puts property for a chance and success and failure depends upon blind chance".

It is true that in both speculation and gambling the element of risk is involved. Risk is found in all commercial enterprises and activities. However, this element involved in speculation and gambling is quite different in nature and purpose. One exists for the economic advancement and the public interest while the other is generally harmful to society. Under the present conditions, it is impossible





entirely to eliminate risks connected with the ownership of grain, cotton and other commodities. With the present large scale production, an enormous amount of surplus products is created every year in this country. In order to distribute this surplus product, producers, manufacturers and even consumers have to take risks occurring from changes in climate, weather and other uncontrollable causes unless there are some persons who are willing to take such risks for them. These persons are speculators who are fully familiarized with crop conditions, market tendencies and economic, political, and social changes in the country and the world, which may affect the value of commodities.

Mr. Merrill states that: "The business on the exchanges is that of a great public-centering on the country's market places for soil products. ....The speculator is typically a student of world's needs, the world's supply and crop conditions and probable outcome. Those true to this type render a great service in intelligently assuming the fair risks of ownership in part of the world's food. The incompetent imitator, introducing much of chance and less of ability, because of being ignorant of the facts acquired by the competent students, is quite another type. One represents cool calculation, the other represents more of blind chance. With one it is business having a serious intent, with the other, a gamble or chance on the outcome"<sup>1</sup>.

One of the functions of the exchanges is to fix prices upon a legitimate commercial basis and to provide for their continued adaptation to the movements of trade and industry<sup>2</sup>. Nevertheless, this

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<sup>1</sup>J. C. F. Merrill, "Truth and Error in the Economics of the Grain Trade".  
p. 10.

<sup>2</sup>Ibid.



important function, sometimes, is not fully accomplished because all kinds of adventuring traders or unskilled operators who have not given serious study to the question of the fluctuations of prices and market movements, participate in the exchange business with a view of acquiring large profits. However, it must be admitted that there are several defects or evils of speculation such as the possibility of price "manipulations", "cornering", "bucket shops", etc., which ought to be abolished in the public interest.

Those who have the conception that speculation lowers prices are usually the producers and those who think that speculation raises the prices are among the consumers. However, both the producers and consumers misconceive the true nature of speculation. The professional speculators are in the market not for the purpose of either depressing or raising prices. They are as ready to make profit on a rise as on a fall in prices. Mr. Carl Parker says: "As to the objections to speculation that it raises prices, or lowers prices according to the point of view, it is only necessary to point out that speculation has always existed where uncertainty exists, that it is the effect of conditions and not the causes of them, that its object and reason for being is to foresee and anticipate price changes by buying and selling and not to create them"<sup>1</sup>.

Furthermore, we can prove the fact that speculation does not necessarily tend either to lower or raise prices by quoting the following

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<sup>1</sup>Annals Amer. Acad. Vol. 38. p. 131.





conclusions on speculation and prices in the report of the United States Industrial Commission in 1901. It says: "As we have attempted to show, it is a mistake to represent speculation in 'futures' as an organized attempt to suppress prices to producers: (1) Because every 'short seller' must become a buyer before he carries out his contract; (2) because as far as 'spot' prices are concerned, the 'short seller' appears as a buyer and not as a seller, and therefore, against his own will, is instrumental in raising prices; (3) because, as far as 'future' prices are concerned, the 'bull' in speculative buying counteracts the effects of speculative selling of the 'bear'; (4) because the 'bull' in his realizing operations when depressing prices, is counteracted by the opposite effect of the 'covering' movements of the 'bear', the two sides thus keeping the market price about where it would be kept in the long run, if instead of 'bulls' and 'bears' there would be ordinary legitimate buyers and sellers; (5) because, as has been shown, future sales are not made at a uniformly lower price than the corresponding spot price, but on the contrary are on the average a little above 'spot prices' to meet the cost of storage, interest, and other charges; (6) because, as has been shown, neither the 'bears' nor the 'bulls' are uniformly on the winning side, but are about equally losers and winners, thus proving that one is about as important and influential a factor in the market as the other; (7) because evidence believed to be conclusive has been presented showing that, under speculation, prices prevailing at the time when producers dispose of the greater part of their products are greater in the comparison to the rest of the year than they were before the advent of modern speculation"<sup>1</sup>.

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<sup>1</sup> Reports of the United States Industrial Commission of 1901. Vol. 6. pp. 222-223.



This quotation is perhaps sufficient to illustrate the real effects of speculation on prices.

That the existence of the organized exchanges is necessary and indispensable to the best advancement of economic life and that its importance in distribution and production of commodities is very great, has more and more been realized by the public. The public interest in the business of the exchanges is vital and immeasurable. Although the merits of the exchanges are numerous, there are a few undesirable features in their business activities. As one of the fundamental underlying principles of economic progress, freedom in trade, that is, "open" markets in business of the exchanges is highly desirable enabling the institution to function properly. Whenever the monopolistic element is present in the exchanges, it is detrimental to the best interest of the public, and retards the development of the true functions of the exchanges. Therefore, the public should take some steps to do away with the monopolistic element in the exchange business. Price manipulation and "cornering" devices should be suppressed. Hence, public regulations are absolutely necessary and desirable not only for the elimination of the evils but for the development of the functions of the exchanges. However, public regulation should not be pushed too far. It should aim to prevent abuses and yet at the same time, not impose too great restrictions upon the business activities of the exchanges. Too strict regulations may result in harmful consequences to the public interests. The regulations should not destroy speculation or limit too narrowly exchange operations. The real problem is to remove the evils and to preserve the benefits. Much of the opposition to the exchanges is caused by the general ignorance of their real functions. As some writers have



already suggested, the best possible remedy for the evils and the best guarantee for the development of the functions of the exchanges is greater public education.





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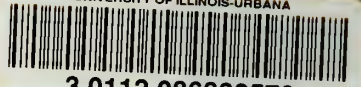
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